PRI Principles for Responsible Investment

ACTIVE OWNERSHIP 2.0:

THE EVOLUTION STEWARDSHIP URGENTLY NEEDS

UNEP FINANCE INITIATIVE | United Nations Global Compact

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.

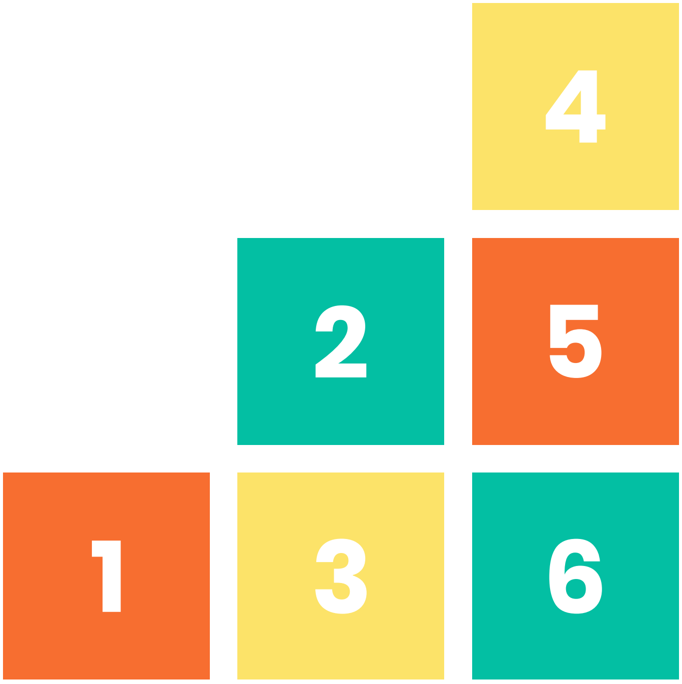
2 We will be active owners and incorporate ESG issues into our ownership policies and practices.

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.

ACTIVE OWNERSHIP 2.0: THE EVOLUTION STEWARDSHIP URGENTLY NEEDS

Active Ownership 2.0 is a proposed aspirational standard for improved stewardship. It builds on existing practice and expertise but explicitly prioritises the seeking of outcomes over process and activity, and common goals and effort over narrow interests.

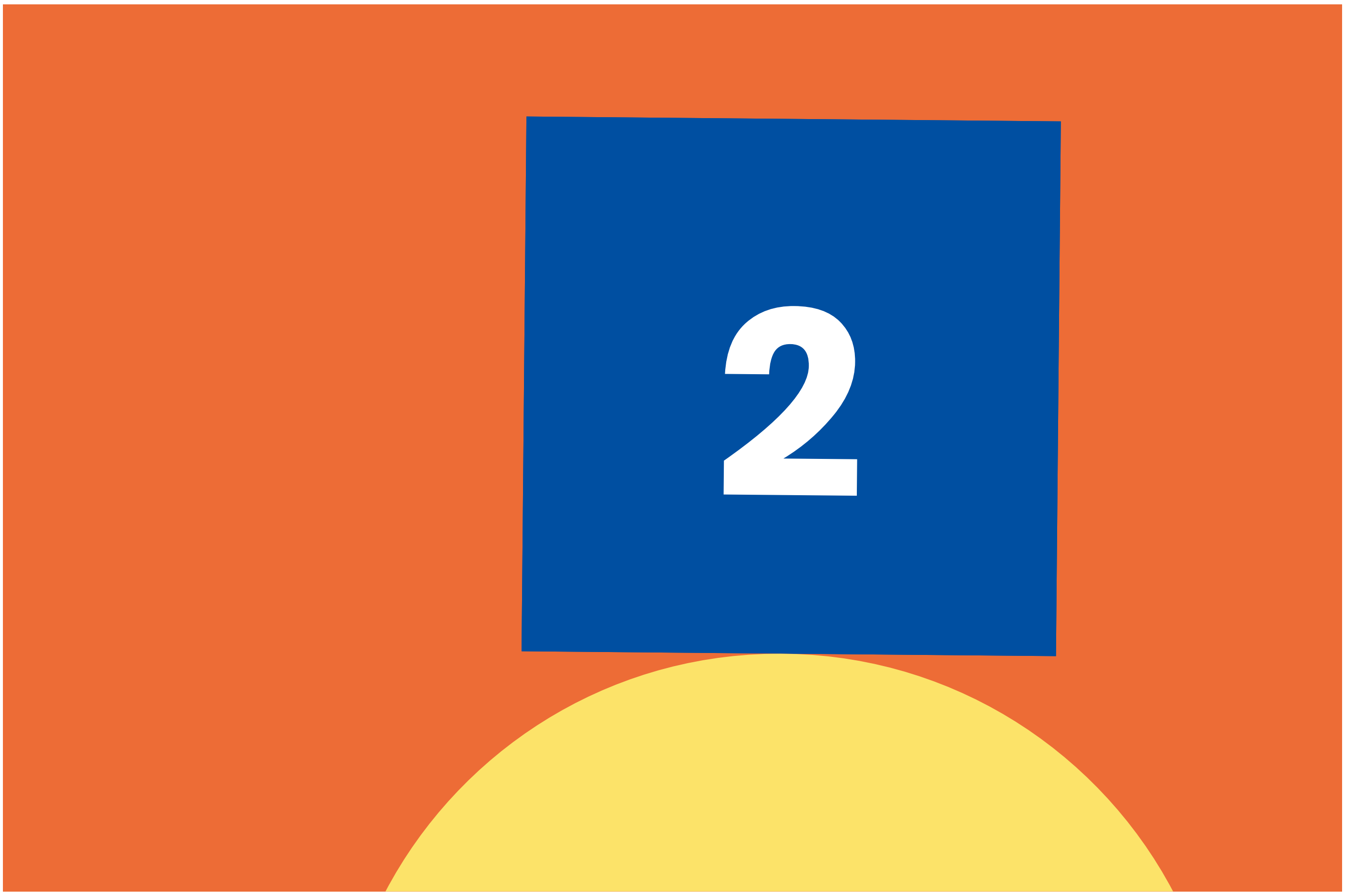
This paper sets out the case for change and a high-level framework for what the standard could involve.

RETURNING TO FIRST PRINCIPLES

Consistent with the Blueprint for Responsible Investment, the PRI recognises the need to focus on the effectiveness of active ownership in producing real-world outcomes[1] at scale, and its own role in better supporting signatories to deliver them. Achieving such outcomes matters: systemic risks, such as climate change and inequitable social structures, seriously threaten the long-term performance of economies and asset owners' portfolios, as well as the world in which their beneficiaries live.[2]

When PRI was established in 2006, its founders recognised the power and potential of active ownership (or 'stewardship') and codified it as the second of the six PRI principles. Active ownership is the means by which investors most directly influence companies, markets, and economies; and, in turn, society and the environment as a whole. In the years since the PRI's establishment, active ownership has been affirmed by the stewardship codes that financial regulators have introduced in many jurisdictions.[3] At the same time, industry capabilities have developed to meet this need, in the form of internal stewardship teams[4] and external services.[5] It has also been strengthened as both individual engagement efforts and new investor networks have reached scale.[6]

With mechanisms and momentum for active ownership now in place, it is time to evaluate how active ownership needs to evolve to meet the original goals and realise its full potential.



[1]That is, real-world results on systemic risks such as climate change and on issues covered within the UN Sustainable Development Goals.

[2]Evidence for the potential of such impacts abounds. For example: recent research from UK thinktank IPPR compares the impact of climate and environmental breakdown to that of the 2008 global financial crisis, noting that the world faces a 'new domain of risk'; the PRI-commissioned Inevitable Policy Response research points to the likelihood and impact of abrupt regulatory disruption as climate policy is rapidly strengthened; and the UN recently estimated that corruption costs the global economy US$3.6 trillion annually, equivalent to more than 5% of global GDP.

[3]See www.icgn.org/policy/global-stewardship-codes-network.

[4]Willis Towers Watson notes that, among a sample of six large investment managers, the average stewardship team has grown from seven members in 2013 to 18 in 2018.

[5]For example, in its annual PRI transparency report, Hermes Equity Ownership Services reported a 27% growth in staff numbers in 2019 compared with 2018.

[6]The PRI estimates that more than 168,000 investor-company engagement meetings took place in 2018, as reported via the PRI reporting framework in 2019. Climate Action 100+ has now grown to be the largest collaborative investor engagement to date, with 370 investors with more than $35 trillion in assets under management taking part.

ADDRESSING STRUCTURAL MYOPIA

Investors'[7] interest in achieving returns while minimising risks typically results in sharp focus by the industry on companies and other assets in which they invest. However, too sharp a focus can, in aggregate, undermine broader investment, economic and social goals. This paradox is one of the challenges that the PRI and its signatories came together to address.

One example of this is short-termism. PRI signatories explicitly recognise that a focus on short-term returns can undermine long-term investment performance. The use of ESG integration to help draw long-term risks into the investment view is now widely accepted.

Short-termism results from optimising for too short a timeframe. Other problems, by contrast, result when investees optimise for too narrow a scope. Examples include:

- A company strengthening its position by externalising costs onto others.[8] The net result for the investor can be negative when the costs across the rest of the portfolio (or market/economy) outweigh the gains to the company;
- A company or sector securing regulation that favours its interests over others.[9] This can impair broader economic returns when such regulation hinders the development of other, more economic companies or sectors;
- A company or sector successfully exploiting common environmental, social or institutional assets.[10] Notwithstanding greater harm to societies, economies, and markets on which investment returns depend, the benefits to the company or sector can be large enough to incentivise and enable them to overpower any defence of common assets by others.

In aggregate, a focus that is excessively narrow can result in poorer economic performance and/or social and environmental harm.[11] These impacts are in turn felt by diversified (universal) asset owners and their agents (including investment managers), as systemic (or 'beta') impairments to overall (or absolute) returns. Beneficiaries, communities and ecosystems face further effects in the form of harms to people and the environment.

While short-termism is increasingly, although not completely, addressed through integration (i.e. Principle 1), issues associated with scope (rather than time) warrant greater attention. Effectively addressing such issues at scale requires more than integration or investment business-as-usual can deliver.

[7]"Investors" in this document refers to asset owners and investment managers, although we note the differences in position, incentives and structures between these two categories (and subsets within each).

[8]For example, a company polluting the water that other companies rely on.

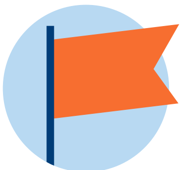
[9]For example, an oil and gas company lobbying successfully for diesel subsidies.

[10]For example, a media company catering to extremists or promoting distrust of regulation.

[11]For instance, corruption may (perversely) be in the narrow financial interests of an individual company, yet as cited in footnote 2 above, costs the global economy US$3.6 trillion annually, equivalent to more than five percent of global GDP; on top of its impacts on societies and the environment.

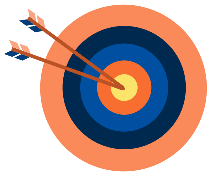
INTRODUCING ACTIVE OWNERSHIP 2.0

Active Ownership 2.0 is a vision for an evolved standard in stewardship that is underpinned by an increase in investors' ambition and assertiveness. It builds on existing practice and expertise but explicitly prioritises critical systemic goals and collective effort aimed at concrete outcomes, rather than processes and activities or narrow interests. The three central elements to an Active Ownership 2.0 approach are set out below.



OUTCOMES, NOT INPUTS OR PROCESSES

Active ownership 2.0 prioritises the pursuit and achievement of positive real-world goals. While resources, [12]activity metrics[13] and intermediate goals[14] are among the levers available to signatories, these are neither sufficient nor universally relevant in the delivery of outcomes.



COMMON GOALS

Systemic issues require a deliberate focus on and prioritisation of outcomes at the economy- or society-wide scale. This means stewardship that is less focused on the risks and returns of individual holdings, and more on addressing systemic or 'beta' issues such as climate change and corruption. It means prioritising the long-term, absolute returns for universal owners, including real-term financial[15] and welfare outcomes for beneficiaries[16] more broadly.

COLLABORATIVE ACTION

Focusing on collective goals and the delivery of positive real-world outcomes is possible only through enhanced collaboration among investors and service providers.

Challenges inherent in addressing collective systemic issues, such as the free-rider problem (i.e. where some avoid the costs of addressing collective problems, while reaping the benefits), result in weaker pursuit of collective goals relative to those where the distribution of costs and benefits is more equitable.[17] This leaves collective interests comparatively under-addressed by signatories, despite their significance.

Enhanced collaboration – in a variety of forms[18] – spreads the cost of addressing collective goals and is therefore central to achieving the required evolution in stewardship practice.

[12]E.g. team size

[13]E.g. number of engagement meetings

[14]E.g. corporate disclosure

[15]That is, the adjusted spending power of beneficiaries' funds once ESG impacts are included; for example, increases in insurance premiums due to risks of floods or forest fire.

[16]For example, a physically liveable climate or respect for human rights.

[17]For example, a portfolio manager of an actively managed listed equity fund meeting with the CEO of a company to get a sense of the organisation's culture, then deciding to change their level of investment in the company on the basis of that meeting.

[18]For example, enhanced collaboration may involve greater coordination between investors on specific objectives for a company or policy engagement, even if some specific actions (e.g. meetings) are done individually.

IMPLICATIONS FOR THE PRI'S WORK WITH SIGNATORIES

ACTIVE OWNERSHIP 2.0 AS AN OPT-IN HIGHER STANDARD

The PRI is a global and United Nations-supported organisation, with a clear mission to create a sustainable financial system that delivers for investors, the environment and society as a whole. To achieve this, the organisation and its members must act on global systemic issues.

This is recognised in the Blueprint for Responsible Investment and its focus on real-world impact on climate and the SDGs.

The PRI is also, however, a 'big tent' organisation with a diverse set of signatories and an intentionally aspirational structure. The organisation encourages greater ambition amongst its signatory base while respecting the differences among members, whether due to size, sector or location.

Active Ownership 2.0 is therefore structured as a higher standard to which signatories can choose to adhere. This standard is stewardship capable of delivering real-world outcomes at the scale needed to achieve our collective goals.

The implementation of Active Ownership 2.0 will represent a greater challenge for signatories whose responsible investment commitments are still developing. However, these signatories will benefit from greater clarity about the goals they should aim to reach.

Where there are structural impediments to alignment with Active Ownership 2.0, we encourage signatories to provide feedback about these, in order to inform the PRI's Sustainable Financial System programme.

SIGNATORY INTERACTION WITH THE PRI ON ACTIVE OWNERSHIP 2.0

To assist and recognise those who do aspire to the high standard of stewardship embodied in Active Ownership 2.0, a suite of actions will be taken across the PRI's activities (see overleaf):

ATTENTION TO BARRIERS

The PRI will also continue to work with signatories to overcome the structural barriers investors face in working to achieve outcomes. We will continue to: pursue investor rights, including a right to advocate; address information asymmetries that limit investor participation; work to address barriers to collaboration;[21] and work further on structural issues inthe investment chain where these limit effective outcome-focused stewardship.

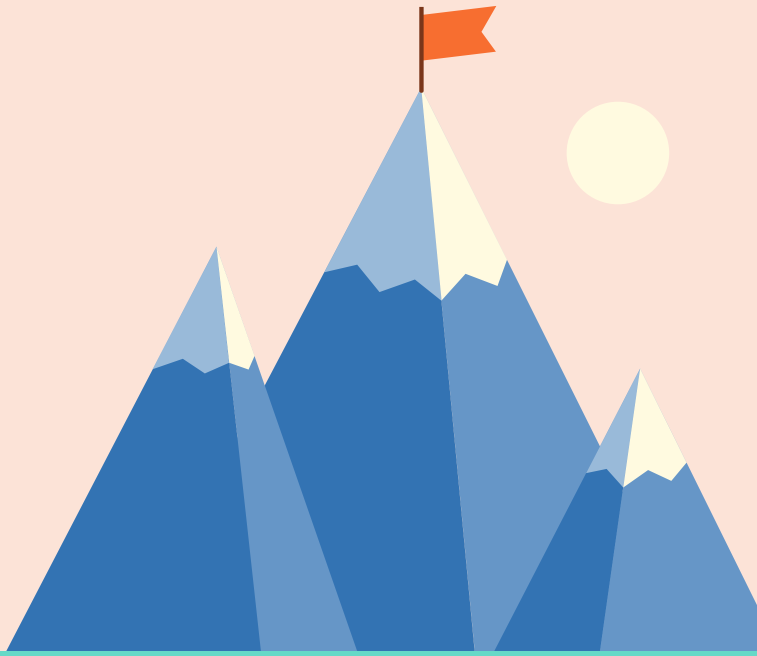
[19]For example, free-rider issues, principal-agent problems and the need to collaborate with competitors.

[20]For example, collaborative engagements.

[21]For example, due to a lack of clarity within acting in concert regulations.

OUTCOMES

To encourage a focus on delivering outcomes on systemic issues, the PRI will support signatories to take effective action, recognising ambition, innovation and resourcefulness in pursuit of common goals. While policies and processes will continue to be important in guiding signatories' implementation, these will no longer be the main focus of PRI's active ownership programme, which instead will emphasise outcomes within its guidance and in assessing signatories' efforts under Principle 2.



COMMON GOALS

In accordance with the Blueprint, the PRI will encourage action on collective goals that deliver climate stability, sustainable development and a financial system that supports the real economy. Focus on these goals will be encouraged through alignment of the PRI's reporting and assessment framework. The PRI will also ensure alignment of its own services to signatories – for example, guides, tools and collaborative engagements – and will support signatories in defining actionable steps towards these collective goals.

COLLABORATIVE ACTION

The PRI's Principle 5 ("we will work together...") already cements collective action as a core element of responsible investment. As part of Active Ownership 2.0, the PRI will enhance its own focus on encouraging, enabling and ensuring recognition for signatory collaboration that addresses matters of collective interest. This includes recognition for the varying degrees of difficulty signatories face in working together for common goals,[19] and explicit recognition of signatories' efforts to overcome related challenges to contribute to collective goals.

The PRI will take particular care to structure and deliver outcome-focused collaborations[20] and provide tools like the Collaboration Platform that support diverse and sometimes competing organisations to work together effectively, recognising the legitimacy of varied contributions, whether direct, financial, or through non-financial means.

WHAT'S NEXT

The PRI will continue to work with signatories to encourage further development of stewardship practice. In that spirit, we would encourage input on this vision via a brief online consultation that will be made available shortly on the PRI Collaboration Platform.

The framework for Active Ownership 2.0 outlined above sets out a clear direction for the PRI's activities. In the months ahead, we will work with signatories to provide more detailed guidance on what it means to implement the aspirational higher standard. This will cover implications for different parts of the investment chain, as well as for signatories of varying size, asset class and geography. Signatories who wish to be more involved are encouraged to contact their network manager or email stewardship@unpri.org.

Upgrading active ownership will demand more of both the PRI and many of its signatories. It will entail a shift in prioritisation and resources, as well as a level of ambition that corresponds to the gravity and urgency of issues facing responsible investors today. This is both a necessary shift that aligns with investors responsibilities to beneficiaries, as well as a positive story and opportunity.

Investors have a significant role to play in achieving meaningful change in our economies, environment and societies. Effective, collective, goal-oriented stewardship is a powerful tool to be wielded to serve these interests, and our interests as responsible investors.

CREDITS

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Nice and Serious

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

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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

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