PRI Principles for Responsible Investment

A SUSTAINABLE FINANCE POLICY ENGAGEMENT HANDBOOK

NOVEMBER 2022

UN environment programme | finance initiative

UN Global Compact United Nations Global Compact

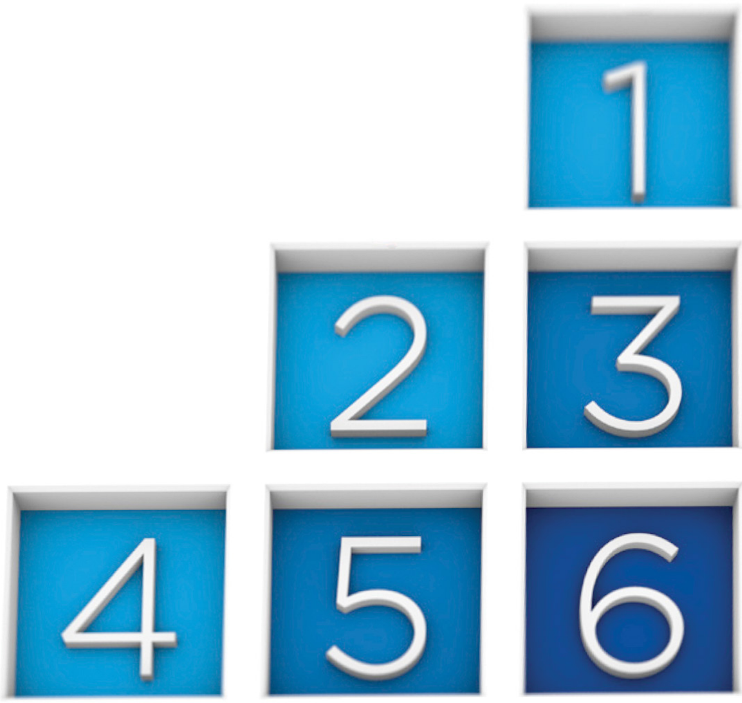
An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

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.

CONTENTS

WHY INVESTORS SHOULD ENGAGE WITH POLICY MAKERS

POLICY MATTERS

Policy sets the rules of the game: it defines roles, responsibilities and accountabilities, it creates risks and opportunities, and it arbitrates between competing interests. Public policy aims to build the foundations that support the development of society towards shared goals, taking into account collective interests and political preferences and addressing market failures.

Public policy sets the rules that govern the financial system and the economy as a whole. Public policy can be defined as a course or principle of action adopted or proposed by government and parliamentary agencies and bodies, including:

- systems of laws;
- national strategies;
- regulatory measures;
- administrative mechanisms; and
- funding priorities.

The importance of public policy for investors has grown in recent years, due to:

- legislative reforms of the financial sector in the wake of the 2008 **global financial crisis**, coupled with stronger and more comprehensive regulation to ensure the stability of the financial sector;
- increased acceptance that environmental, social and governance (ESG) factors can influence the ability of investors to deliver both short-term and long-term **financial returns;**
- governmental need for new **sources of funding,** with a growing consensus that the capital investments required to achieve environmental and social objectives, address collective societal risks and price in externalities are too significant to be borne by public budgets alone;
- the **commitments made by governments** around the world to the Paris Agreement on climate change and the Sustainable Development Goals (SDGs), both of which explicitly recognise the need to deeply reform financial systems to align all financial flows with their objectives;
- growing understanding of the implications of sustainability issues for the stability, resilience and performance of **financial and economic systems;** and
- greater **public awareness** of ESG issues, left unaddressed by current market functioning, which has increased the pressure on policy makers to take action on collective challenges.

Well-designed and effectively implemented public policies support national economic and sustainability objectives, enhance the resilience and stability of financial and economic systems, improve market efficiency, address public concerns regarding ESG issues and increase the attractiveness of countries as investment destinations.

BOX 1: THE PRI'S APPROACH

The PRI recognises that public policy critically affects the ability of and incentives for institutional investors to generate sustainable returns and create value. It also affects the sustainability and stability of financial markets and of social, environmental and economic systems.

The PRI therefore sees that policy engagement by institutional investors is a natural and necessary extension of an investor's responsibilities and duties to act in the best interests of its beneficiaries and clients.

The PRI actively engages with public policy where relevant to its Principles and Mission. Specifically, the PRI has committed to support policy makers in their efforts to establish sustainable financial systems that align capital markets with the goals of the Paris Agreement and the SDGs. Each year the PRI sets out its policy priorities that summarise the key policy topics and developments in core markets where the PRI is conducting policy research and engagement (see page 22). These priorities reflect the PRI's strategy and its current policy agenda in different markets.

BOX 2: WHAT IS POLICY ENGAGEMENT?

Policy engagement refers to engagement with policy makers conducted as part of investors' approach to responsible investment. Policy engagement can be conducted directly or through third parties, working groups or collaborative initiatives, including the PRI.

There are different types of policy engagement. Investors can engage with policy makers to contribute to embedding sustainability criteria and elements in financial regulations. Investors can also engage with securities regulators to, for example, improve corporate disclosure regimes. More broadly, investors may also engage with governments and economic regulators on real-economy policies, for example those relating to energy, transport, etc. All these types of policy engagement are complementary and can be mutually reinforcing in so much as they aim to support sustainable finance policy reform, including on real-world sustainability outcomes.

Investors engage with policy makers by different means: responding to policy consultations, providing technical input via government or regulator-backed working groups, participating in sign-on letters, or by directly communicating with policy makers, etc.

Responsible investors are expected to publicly disclose details of their engagement with policy makers, including disclosing positions developed as part of their responsible investment approach, details of direct engagement with policy makers, and membership of or support for trade associations, think tanks or similar.

THE RATIONALE FOR POLICY ENGAGEMENT

Public policy critically affects the ability of investors to generate sustainable long-term returns and create value. Policy engagement by investors is therefore a natural extension of investors' responsibilities and duties to the interests of beneficiaries and savers

Policy reforms relating to sustainable finance and the alignment of financial flows with sustainability goals are becoming mainstream. Investors have a clear interest in ensuring that these measures are effective, efficient, support sustainable financial returns and deliver clear social and environmental benefits.

Sustainable finance policies and regulations affect investors in many ways:

- **reforms to investor duties and disclosures** clarify the purpose of investment. Such measures can require investors to incorporate all value drivers, including ESG issues, in their investment decision-making, and to report on their ESG-related policies and performance;
- **corporate ESG disclosure regulations** can provide investors with higher quality, standardised ESG data to use in investment analysis and decision making;
- **stewardship frameworks and regulations** clarify and facilitate investor engagement with investee companies, contributing to improved corporate ESG performance, a sustainable transition to net zero, and long-term value creation;
- **sustainable taxonomies** aim to create a shared language on sustainable economic activities for investors and companies to assess whether activities meet defined standards when working towards shared sustainability goals, such as net-zero emissions by 2050;
- **broader sustainable finance strategies** can set out the direction of travel for responsible investors and aim to ensure consistency between the above measures.

By becoming signatories to the UN-supported PRI, some 5,000 finance sector institutions, combining more than US$120 trillion of assets under management, have committed to address "obstacles to a sustainable financial system that lie within market practices, structures and regulation".[1] Policy engagement can be an effective tool for shaping more effective policy frameworks in support of and in alignment with the Principles. The PRI has a track record of promoting policy decisions in areas that have led to investors strengthening their own responsible investment practices.

BOX 3: HOW THE IMPETUS FOR POLICY ENGAGEMENT HAS CHANGED IN THE PAST 10 YEARS

The PRI has been conducting sustainable finance policy research since 2013. In that time, there has been a transformation in the way responsible investors value policy engagement and sustainable finance policy reform. Policy developments related to the six principles have increased both in scope and complexity:

- the number of sustainable finance policy reforms tracked by the PRI's regulation database has increased exponentially, from fewer than 300 in 2013 to more than 800 in 2021 (see Figure 1 below);
- in most developed countries and some emerging countries, sustainable finance policy reform is no longer seen as optional or separate to mainstream, traditional financial regulation;
- the focus of sustainable finance policy is shifting from an emphasis on investment risks and returns to focus on real-world outcomes;
- policy makers are increasingly seeking private sector input to policy making;
- responsible investment is now a norm, with the PRI having 5,000 signatories, reaching more than half of all assets under management worldwide; and
- despite new global crises, including the Covid-19 pandemic and the war in Ukraine, sustainable finance and sustainable economic policy reforms have remained high on government agendas.

1 Source: What is the PRI's Mission?

SUSTAINABLE FINANCE POLICY REFORM: AN OVERVIEW

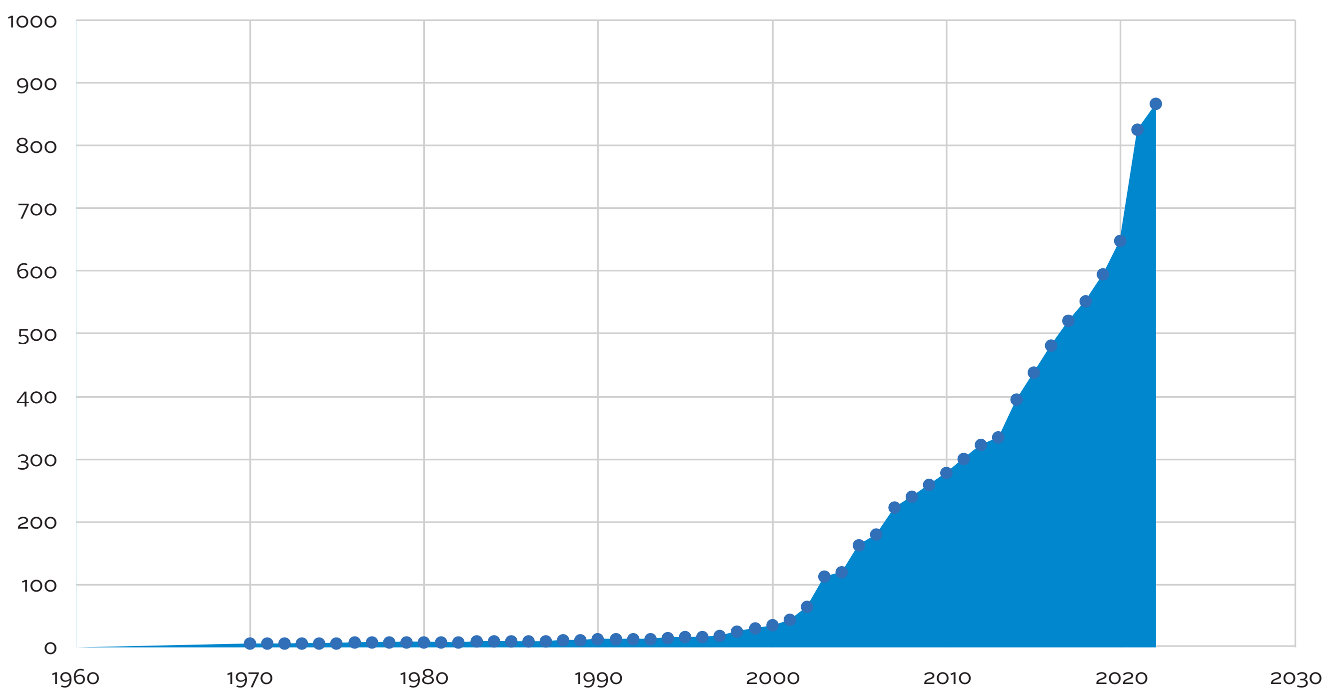
SUSTAINABLE FINANCE POLICY REFORM IN NUMBERS

Government and policy maker interest in sustainable finance and investment has grown substantially since the start of the century. Sustainable finance policy reform was once treated as an optional consideration, generally led by environmental departments and ministries. It is now a key objective addressed by financial policy makers and regulators.

Of the sustainable finance policies identified by the PRI, 96% have been developed since the year 2000. The pace of policy formation continues to increase – the PRI identified 225 new or revised policy instruments in 2021, more than double the number in any previous year.

Since 2010 the number of sustainable finance regulations in six key jurisdictions (the US, Canada, the UK, China, Japan and Australia) has at least tripled, quadrupling in the UK and China and increasing five-fold in Japan.

Figure 1: Cumulative policy interventions Source: PRI regulation database



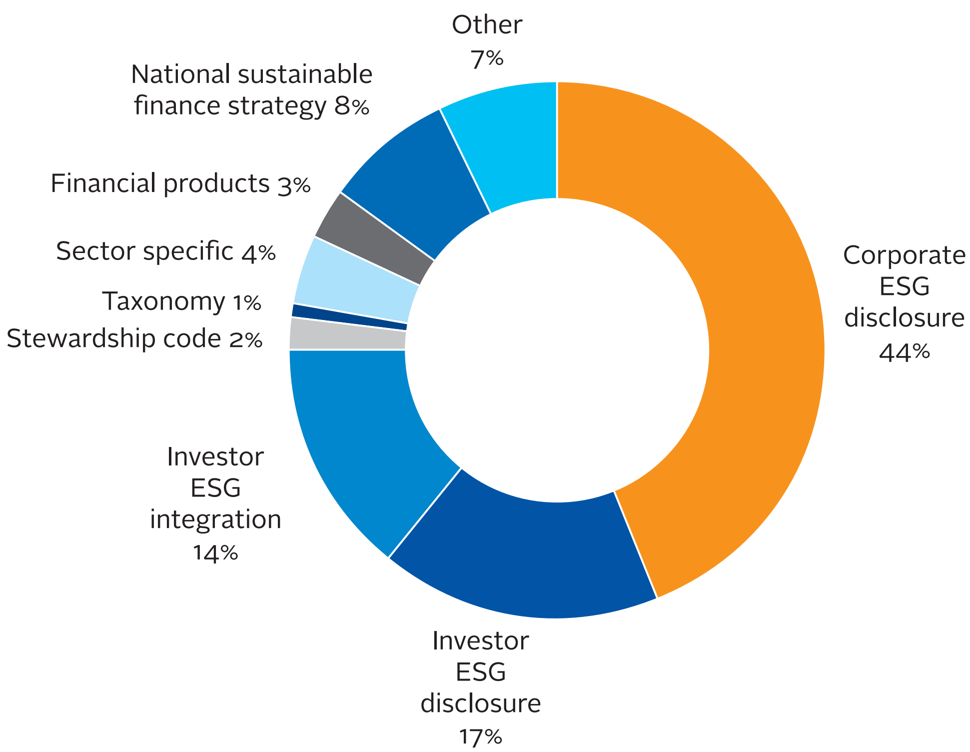
Note, while this graph shows 2022, the regulation database is only as of 31 April 2022.

In terms of the number of policy interventions, the European Union leads the way, accounting for 50% of the entries in the PRI regulation database. However, there has been a rapid increase in policy interventions across all regions. Since 2010 the number of sustainable finance regulations in six key jurisdictions (the US, Canada, the UK, China, Japan and Australia) has at least tripled, quadrupling in the UK and China and increasing five-fold in Japan.

The variety of sustainable finance policies has also increased. Policies addressing corporate disclosures still represent the largest portion, but many sustainable finance policies now govern investor duties and disclosures, taxonomies or broader strategies including industrial transition in alignment with the Paris Agreement and sector-specific policies.

It is noteworthy that almost one quarter of the finalised regulations of 2021 were revisions of current regulations, and this percentage has steadily increased over the past decade. This suggests that policy makers are increasingly aware of the importance of an efficient and coherent financial policy framework. If sustainable finance and investment policies are to realise their full potential (i.e., driving capital towards sustainable, inclusive and zero-carbon activities), global alignment of their scope, requirements and purpose will become an increasingly important feature.

Figure 2: Cumulative policy interventions Source: PRI regulation database. The methodology is available on the PRI website



A CHANGING LANDSCAPE: SUSTAINABLE FINANCE FOR A SUSTAINABLE ECONOMY

The past decade has witnessed profound shifts in public policy and long-term sustainability:

- Policy makers set out strategies that aim to develop coherent, connected reforms across financial, economic and ESG-focused policy
- Core financial policy updates point to a rising trend of global convergence across key foundational financial policy reforms
- The majority of policies are mandatory over time, illustrating their critical nature
- There is a shift of focus from risk and return to considering the outcomes of investment decisions
- There has been a revival of industrial policy making, in an effort to guide an economy-wide transition towards the goals of the Paris Agreement
- Consistency and coherence across government departments, parliaments and market regulators is a prerequisite for effective policy reform

FROM SILOS TO SYSTEMS

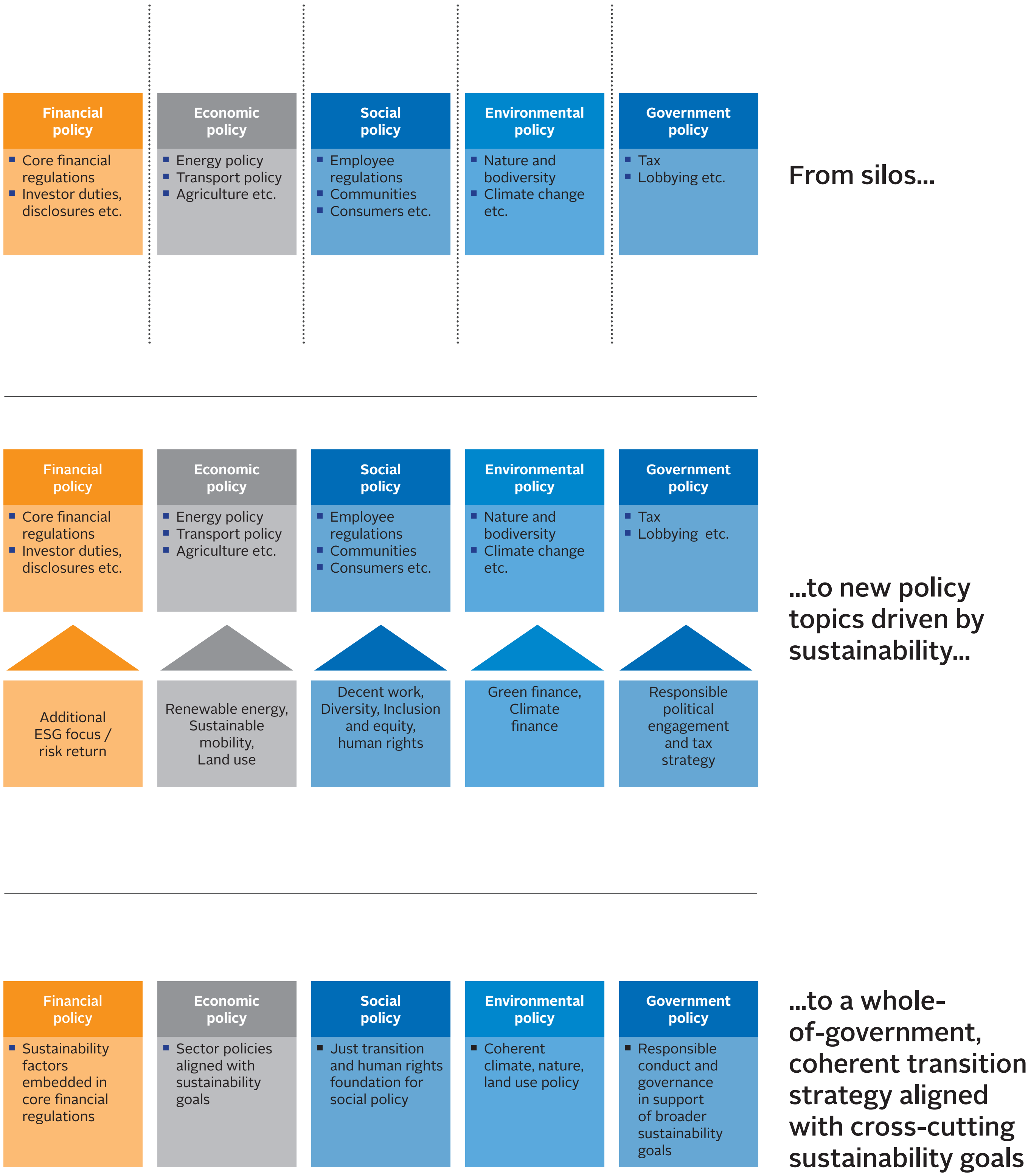
In the 2010s, the increasing interest in and understanding of how ESG issues affect financial and economic performance led to the first reforms across the traditional spectrum of public policies. Such reforms were often designed and developed by dedicated environmental or climate-focused departments. These first regulatory efforts helped develop expertise and raise awareness around new challenges to financial markets. However, they were often conducted in silos, separately from mainstream financial policy making, regulatory oversight and multilateral negotiations.

This has started to change. In recent years, efforts to hardwire sustainability considerations and goals into mainstream financial policy making have put sustainable finance on the front pages of financial media and at centre stage in financial regulation. The development and growing sophistication of responsible investment practices have also powered this shift. These trends have exposed the interconnectedness of environmental, social and governance issues, investment practice and real-economy outcomes.

As a result, a new feature of sustainable finance policy is the growing focus on the real-economy impacts and implications of investment decisions, and the need to recognise sustainable finance policy as an integral part of wider economic policy. For example, the policies required to drive reductions in greenhouse gas emissions in the economy include disclosure requirements for companies and for investors, requirements for investors to integrate climate-related considerations in their investment decision-making, and fiscal incentives for emission reductions (carbon taxes, removal of fossil fuel subsidies, etc.).

Responding to this reality means that policy engagement needs to take place across government departments and regulators, as well as across international boundaries. Ultimately, it requires investors to recognise that, by influencing the frameworks that shape the entire marketplace, policy engagement is a necessary and effective complement to engagement with individual companies. Figure 3 illustrates this shift to a coherent, whole-of-government transition strategy.

Figure 3: From silos to systems: the relationship between financial and real-economy policies[2]



2 Note, while this graph shows 2022, the regulation database is only as of 31 April 2022.

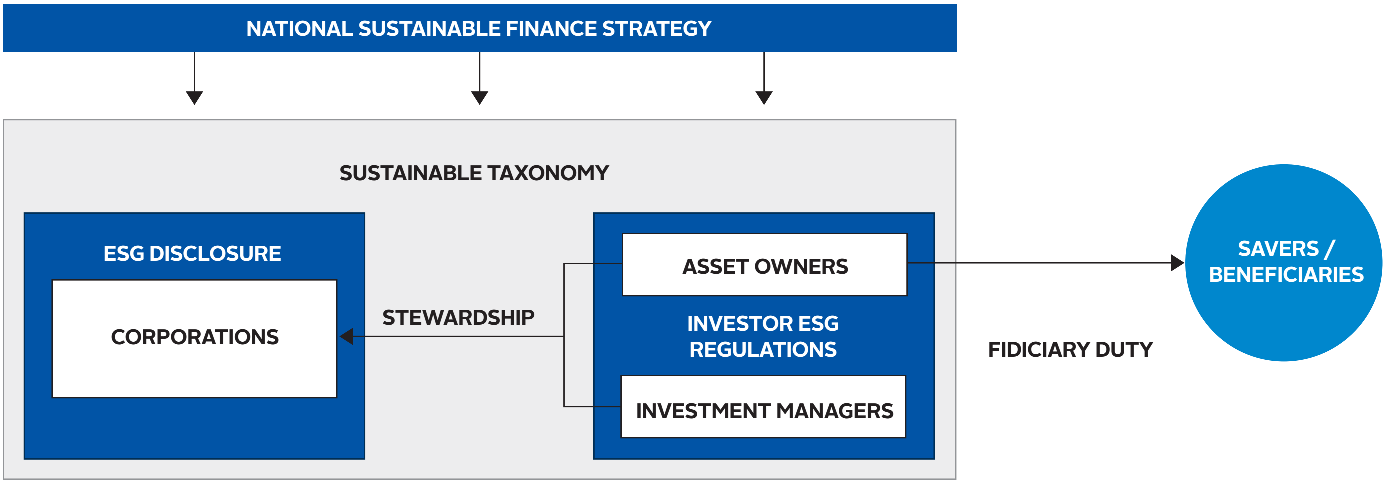
FROM SPORADIC REFORMS TO GLOBAL CONVERGENCE IN FINANCIAL REGULATIONS

The PRI's regulation database shows that policy reforms around the world seek to address similar concerns across the investment value chain (see Figure 4). They aim to clarify investor duties, provide investors with comparable, standardised data and information on key ESG issues, require investors to disclose how they incorporate such information in investment decision-making and how they act to improve investee performance, etc. These are summarised by the policy toolkit series developed by the PRI and the World Bank.[3]

The core financial policy reforms include:

1. corporate ESG disclosure requirements, including alignment with the recommendations of the Task Force on Climate-related Financial Disclosures and developing global standards, such as those from the International Sustainability Standards Board;
2. stewardship frameworks and regulations, covering engagement with companies and other issues, and proxy voting;
3. formal duties of investors to incorporate ESG-related considerations into their investment decision making, to provide sustainability-related disclosures and to report on their ESG incorporation policies and performance targets;
4. taxonomies of sustainable economic activities, defining common criteria to classify projects or investments as green or sustainable; and
5. national/regional sustainable finance strategies that encourage and enable the low-carbon transition and the delivery of the SDGs.

Figure 4: Priority elements of sustainable investment policy and regulation



3 The PRI is working with the World Bank's Financial Stability and Integrity Team to support government policy makers and regulators in implementing reforms to build a sustainable financial system. The first output from this work is the Toolkit for Sustainable Investment Policy and Regulation, which provides a high-level overview of five foundational sustainable investment policies, explaining why each is important, setting out their key features and presenting some examples of such policies in action (For more information, see www.unpri.org/policy/policy-and-regulation-toolkit).

SUSTAINABLE FINANCE IS NOT OPTIONAL: AN EMPHASIS ON MANDATORY REQUIREMENTS

The majority of sustainable finance policies are mandatory rather than voluntary, to address the issue of free-riding and creating a level playing field for all finance sector actors in terms of, for example, reporting requirements and duties. Almost four fifths (78%) of policies completed or commenced in 2021 were mandatory, compared with 45% in 2010. Underlying many of these reforms is a clear impetus for collective action; many of the historic barriers to collective action (e.g. concerns about acting in concert) are being removed, and new market practices (e.g. participating in collaborative initiatives, collective company engagement) are being established.

FROM ESG RISK MANAGEMENT TO SUSTAINABILITY OUTCOMES

Over the past two decades, it has become increasingly accepted that investors should incorporate ESG factors into their analysis and decision-making in order to meet their financial objectives and discharge their fiduciary duties. The 2005 Freshfields Report and its sequel, Fiduciary Duty in the 21st Century, helped drive this change in investor behaviour.

Investors' ability to generate consistent financial returns depends on the stability and viability of the environmental and social systems on which the economy relies. Accordingly, many institutional investors now accept that acting in their clients' and beneficiaries' best financial interests requires them to consider the positive and negative impacts of their activities and to proactively shape the sustainability outcomes of those activities.

With this objective in mind, leading investors are increasingly setting sustainability impact goals across their portfolios. These are often intended to contribute to the achievement of global objectives, such as those of the Paris Agreement, the SDGs and international commitments on human rights. Investors are pursuing these goals through a combination of asset allocation, increasingly forceful stewardship and direct engagement on key public policy issues.

The Legal Framework for Impact, drawn up by law firm Freshfields for the PRI, the Generation Foundation and the UNEP Finance Initiative, sets out the legal foundation for such actions. Across jurisdictions, investors are generally permitted, and at times required, to consider sustainability outcomes where doing so would support their financial objectives. However, the policy and regulatory landscape does not always provide investors with adequate clarity, guidance or tools to support them in shaping sustainability outcomes. As a result, many investors still do not systematically consider their ability and responsibilities to do so. It lends support to the case for financial policy and regulatory reforms to overcome this inertia and facilitate a progression from ESG risk management to delivering outcomes.

THE ROLE OF INDUSTRIAL POLICY TO PILOT THE ECONOMIC TRANSITION

The need to accelerate the low-carbon transition has presented governments with a challenge: how to pilot an economy-wide transition where much sustainable finance policy reform has focused on disclosure? The need for a coherent, whole-of-government policy approach points to a revival of industrial policy in the 21st century.[4] Such policies include the EU's Fit For 55 strategy, while in 2022, the French government set a 'planification' strategy to pilot the ecological transition. Even in the UK, where the ruling Conservative party has traditionally baulked at large-scale government intervention in the economy, it unveiled in 2020 a "Ten Point Plan for a Green Industrial Revolution".

While industrial policy may not be popular among some economists, the need to reorient economies, financial flows and market behaviour towards a common goal, and manage related risks, calls for a new type of government intervention. Industrial policy 2.0 needs to address key risks posed by climate change and its implications for economic and social systems. It will likely combine policy measures across financial, economic and ESG domains, using different regulatory tools.

Such policy measures directly affect the returns that can be achieved in different sectors and related capital flows. Investors therefore have a direct interest in ensuring that such policies are efficient and that they are designed to best reach the multiple goals they pursue. Engaging with policy makers in the design and development of industrial policy and broader sustainable finance strategies is a logical extension of the duties investors have to their clients and beneficiaries to manage sustainability issues and impacts that affect financial returns.[5]

THE NEED FOR POLICY COHERENCE AND CONSISTENCY

We are in a time of ever-increasing risks of negative sustainability impacts, not only from climate change but also from biodiversity loss, human rights abuses, antimicrobial resistance, tax corruption, etc. Simultaneously, as noted above, the number of sustainable finance policies being introduced in response is increasing every year. But the proliferation of such policies also brings risks, including that they are not coherent and consistent with each other and international standards and science. Coherence is also important to reduce the burden on investors (and other actors) who might be required to comply with a range of different policies across different jurisdictions. Given that many jurisdictions are at the early stages of their sustainable finance journey, it is in investors' interests to engage with policy makers to ensure that new policies are effective and coherent.

4 Industrial policy is defined here as a state's broader economic strategy to encourage economic transformation.

5 See, further, PRI, UNEP FI and the Generation Foundation (2019). A Legal Framework for Impact and PRI, UNEP FI and The Generation Foundation (2019), Fiduciary Duty in the 21st Century: Final Report.

THE FOUNDATIONS OF POLICY ENGAGEMENT

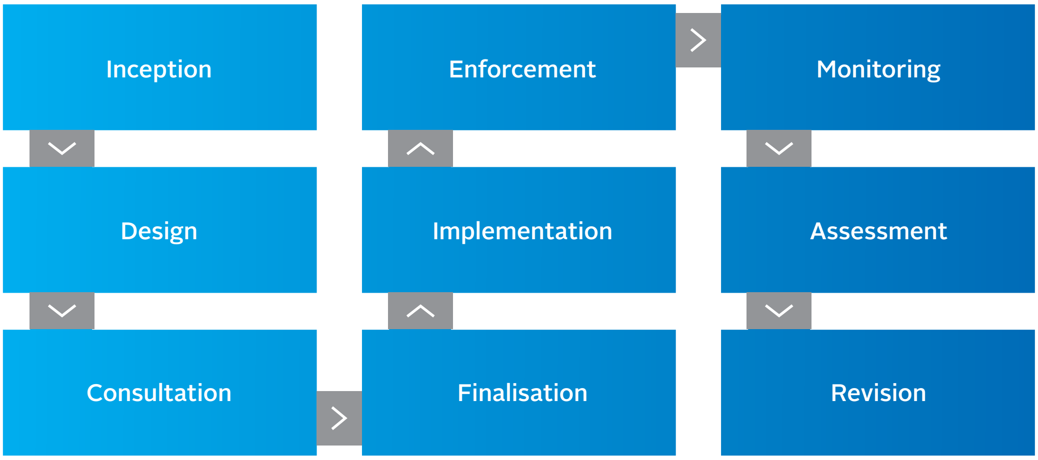
UNDERSTANDING THE POLICY LIFE CYCLE

Sustainable finance policy reform can entail a deep transformation of existing policy and regulatory frameworks. Most policy development processes will generally involve similar stages where investor input can help design more effective policies, adapted to the challenges that responsible investors face.

As set out in Box 2, investors can contribute to different types of policy reform, ranging from those that affect their duties directly (for example, financial regulations such as the EU Sustainable Finance Disclosure Regulation), to regulations that affect listed companies (such as the EU Corporate Sustainability Reporting Directive) and broader, real-economy policies and government strategies (such as the EU's Fit for 55 strategy and RePowerEU).

Although every jurisdiction will have a different regulatory structure governing financial markets, the current trend to embed sustainability throughout existing frameworks offers numerous opportunities to engage in the process of policy reform. In most markets, the life cycle of the policy reform process is structured as shown in Figure 5.

Figure 5: The policy life cycle



Box 4 provides an example of a policy development from inception to assessment and revision, using the EU taxonomy. Figure 6 illustrates the different stages and presents the opportunities for policy engagement by investors.

BOX 4: THE EU TAXONOMY, AN EXAMPLE OF THE POLICY CYCLE

1. **Inception**
   Following the Paris Agreement in 2015, EU policy makers began to explore in a holistic way how policy could encourage financial flows towards sustainable economic activities. In 2016 the G20, under the Chinese Presidency, set up a green finance study group that highlighted the lack of clarity surrounding definitions of sustainable as one of the key barriers to sustainable finance.

2. **Design and consultation**
   In 2016 the European Commission appointed a group of sustainable finance experts, the High-Level Expert Group on Sustainable Finance (HLEG), to write a report "recommending a comprehensive programme of reforms to the EU financial policy framework, including a clear prioritisation and sequencing". Members consisted of sustainable investment professionals and organisations, including the PRI.

   The final HLEG report was published in January 2018. Its first key recommendation was to "establish and maintain a common sustainability taxonomy at EU level." Arguably, the Commission's decision to appoint this group was a key determining factor in setting the ambition and quality of sustainable finance policies that followed.

   In 2018 the European Commission published its Action Plan on Financial Sustainable Growth, based on the HLEG report. It set out three main objectives: i) reorient capital flows towards sustainable investment, ii) manage financial risks stemming from ESG issues, and iii) foster transparency and long-termism in financial and economic markets.

3. **Finalisation**
   A legislative proposal for the "establishment of a framework to facilitate sustainable investment" came soon after, and a political agreement was reached at the end of 2019. The framework established that, to be considered sustainable, activities must: i) make a substantial contribution to an environmental objective, ii) do no significant harm to other objectives, and iii) meet minimum social safeguards. The final text stipulated that technical screening criteria for the various economic activities would be set out in delegated acts.

4. **Implementation**
   The Commission then established new expert groups – the Technical Expert Group, which later became the Platform on Sustainable Finance – to advise on the development of the criteria. The membership of these groups was made purposefully broader than the HLEG's to reflect the wider scope and impact of the regulation – and included investors, banks, corporates, academics and NGOs. This group has been important in ensuring the criteria are backed by scientific evidence, and to counterbalance the interests of different Member States wishing to classify certain technologies and activities as sustainable. Two delegated acts for climate change mitigation and adaptation were adopted in 2021 and 2022, and the adoption of another covering the remaining environmental objectives is expected by 2023.

   Regular public consultations have been held throughout the process by both the Commission and the expert groups to gather feedback from investors and other market participants.

5. **Monitoring, assessment and revision**
   The Platform has also been handed a mandate to work on several issues related to the implementation and development of the taxonomy, such as:

- the usability of the taxonomy and issues related to data availability;
- the potential extension of the taxonomy to cover further levels of environmental performance (intermediate performance and significant harm to environmental objectives);
- the potential development of a social taxonomy; and
- monitoring trends regarding capital flows into sustainable investment.

The European Commission and European supervisory authorities work in close collaboration with the Platform to effectively support the effective application of the taxonomy by the market. Under Art 26 of the Taxonomy Regulation, the European Commission must publish a report on the application of the regulation every three years starting from 2022.

Figure 6: Policy maker action and the investor role in policy development

Policy development stage	Policy maker action	Investor role
1. Inception	Define a strategy and/or set objectives to develop and/or update a given policy or regulation. At this stage, decisions are made on what issues might be covered, and on how to proceed. This process involves: ▪ discussions about the issue; ▪ the information needed; ▪ the type of intervention; ▪ the key actors to be consulted; ▪ the policy options that may be available; and ▪ the political implications of taking (or not taking) action.	▪ Initiate or support a policy reform to address a specific gap, market failure or new issue, or to adapt to changing circumstances.
2. Design	Conduct analysis and develop proposals. This process includes: ▪ reviewing the available evidence; ▪ discussing the proposals with key stakeholders; ▪ conducting initial analysis of the issue in question; ▪ analysing the options for action; ▪ analysing the merits of alternatives; ▪ assessing the likely effectiveness of the options available (including the 'do nothing' option); ▪ analysing the financial costs and benefits of taking action; ▪ assessing the potential side effects of action; ▪ analysing how the proposed policy would fit into the current policy framework; and ▪ determining evaluation/assessment criteria.	At this stage, policy engagement is critical. The direction of a given policy is already set, but the type of intervention can still be shaped and adapted towards the most effective solution. Investors might: ▪ provide information; ▪ formulate asks and recommendations in a direct engagement (via letters to the policy maker); ▪ participate in working groups; and ▪ provide technical expertise and evidence.
3. Consultation	Conduct consultation with key stakeholders to collect input and feedback before finalising a policy. In such a consultation, policy makers publicly set out the rationale for intervention, objectives of the policy, options for implementation – often including their proposed lead option – and their analysis (this can include impact assessments, cost-benefit analysis, stakeholder feedback etc.).	▪ Respond to the consultation. ▪ Sign letters to support a collective response, or other statements setting out their views. ▪ Publicly express views in support of and/or to improve the proposed policy.
4. Finalisation	Incorporate stakeholder feedback, finalise the draft rule, obtain approval for the rule (e.g. if parliamentary approval is needed), publish the policy and confirm the start/implementation date.	▪ Engage with policy makers as they assess the feedback. ▪ Stay informed on the final outcome. ▪ Publicly support the outcomes and/or call for improvements.

Policy development stage	Policy maker action	Investor role
5. Implementation	Implement and enforce the new policy, rule or law.	▪ Call for further guidance if there is a lack of clarity around implementation.
6. Monitoring and enforcement	Collect data and information on the implementation and impact of the policy. Policy must be enforced and rules complied with by stakeholders (in particular to avoid "greenwashing").	▪ Provide evidence on the impacts and implications of the policy. ▪ Provide examples of good practice.
7. Assessment	Review the effectiveness, dependability, costs, intended and unintended consequences, and other relevant features of the policy measure in question.	▪ Provide comment on whether the policy measure remains relevant to its original goal and how the policy measure may be strengthened.
8. Review	Decide, based on Steps 5 and 6, whether the policy needs to be reviewed, updated or discontinued. Depending on the decision, this may involve a further process of inception, design, consultation and finalisation.	▪ Propose feedback/options for improvements or adjustments to the policy.

PRACTICAL RECOMMENDATIONS FOR POLICY ENGAGEMENT

We recommend that investors seeking to undertake policy engagement:

1. Understand the specificity of policy engagement
2. Identify opportunities to engage, directly or through initiatives like the PRI
3. Collaborate with other investors, exchange views and support common goals
4. Set up a strategy and commit resources to engage effectively
5. Set up internal processes to ensure compliance and accountability
6. Build relationships for the long term

Many of the PRI's signatories have developed extensive experience in carrying out engagement with policy makers over recent years. The following pages offer a number of recommendations that might be considered by those investors beginning to embark on policy engagement.

HOW POLICY ENGAGEMENT IS DIFFERENT TO CORPORATE ENGAGEMENT

Public policy engagement by investors differs from corporate engagement in four important ways.

- **Engagement with policy makers involves longer timeframes than engagement with companies or issuers.** There is need to achieve buy-in for policy intervention, political appetite and 'room' to engage in it, and capacity among policy makers to go through the policy making and implementation process. For example, the US Securities and Exchange Commission adopted guidance requiring companies to report on climate change-related risks seven years after Ceres first called for such disclosures.
- **Investors are often not the most important stakeholders.** In corporate engagement, the relationship between companies and the investors who own them is clearly defined. In contrast, the policy process involves multiple stakeholders, such as companies, non-governmental organisations, trade unions and consumers, frequently with competing interests. One consequence is that investors may not have a significant opportunity for involvement at the policy inception or design phases.
- **Policy makers need to balance a range of factors in their decisions.** For policy makers, the implications for investors are just one of many considerations and are not necessarily the most important. Often, interests of investors and corporations are bundled together as those of the 'private sector', even if those interests may be quite different. Policy makers need to consider a wide range of factors when designing and implementing policy, including overall effectiveness, economic efficiency, regional/distributional impacts, employment consequences, competitiveness effects, learning and innovation benefits, and public acceptability, as well as alignment with wider social, environmental and economic priorities.
- **Public policy implies implementing and enforcing regulatory provisions, providing both rights and obligations for various stakeholders.** Contrary to company engagement, there is a limited space for dialogue once rules are enforced.

In engaging with the policy process, investors might:

- **sign public statements or letters from investor groups**, such as the PRI, on sustainability-related public policies;
- **contribute to the work by the PRI, and other investor groups** or industry bodies, to develop responses to consultations on sustainability-related public policies;
- **respond to consultations**, individually, through PRI policy work, or in collaboration with other investors;
- **engage directly with policy makers** to provide technical input relevant to the policy under development;
- **challenge investee company management** when corporate positions on public policy matters, and those of their trade associations, run counter to long-term investor interests; or
- **join investor working groups**, coalitions and initiatives working on specific policy topics.

COLLABORATING WITH OTHER INVESTORS

Some investors conduct public policy engagement in collaboration with others. This may be through formal, well-established domestic and international networks, or through smaller, informal groups of like-minded investors that come together to discuss a particular topic for a particular period of time. Within the investment community, there are a number of well-organised collaborative initiatives focused on promoting long-term investment practices. Many of these have an explicit focus on public policy engagement. Collaborative engagement can offer significant advantages to acting in isolation, including:

- **pooled resources:** collaboration helps to avoid the duplication of effort, allows tasks and responsibilities to be shared, and offers smaller and resource-constrained investors the opportunity to lend their support to the collaboration process and to have their voice heard in policy engagement processes;
- **a unified voice:** a collective position enhances power and legitimacy, showing policy makers that the views expressed are shared with a wider group, maximising the efficiency of external engagement, and can allow investors to act as a strong counterweight to opposing views expressed by other lobby groups;
- **strategic organisational structure:** given that the policy development process can take many years, collaborative groups can help achieve consistency and longevity; and
- **development of knowledge and skills:** this includes both the substance of the issue in question and the policy process in general.

However, one risk faced by collaborative initiatives is that the need to reach agreement among participants means that the positions adopted become less stretching or less demanding than those that would have been adopted by organisations engaging with policy makers on their own.

ENGAGE EFFECTIVELY

To ensure that policy engagement is effective, investors and investor collaborations should:

- **have a clear rationale for action:** the issue in question must be both important and there should be a reasonable likelihood that policy action will be effective;
- **provide a detailed explanation of the impact on the beneficiaries** that investors represent;
- **engage early:** at the early stages of the policy process, policy makers often look for advice and suggestions from different stakeholders. Raising issues at the beginning of a new administration or head of state's term in office may help shape the agenda or specific topics for the rest of that term and may be better than waiting until later when other priorities may have taken precedence;
- **understand and work to policy makers' timetables:** the policymaking process tends to play out in fits and starts. Periods of intense reform, often seen during a crisis, may be followed by years of calm. The window for change closes fast, and when specific policies are being developed it is important to engage early to understand the main upcoming milestones and identify key influence points;
- **recognise that policy makers must balance the needs and interests of different stakeholders:** this may mean that the options preferred by investors are not considered acceptable or legitimate by other stakeholders. Of particular importance in this regard is recognising that economic efficiency is just one factor considered by policy makers;
- **articulate the benefits in terms that are of interest to the policy maker** in question: for example, policy makers will tend to favour initiatives that respond to multiple objectives across broader government strategies (e.g. job creation, growth, etc);
- **be consistent in their messages** and be prepared to maintain their focus on the issue for the duration of the policy development process, which can often be over a number of years or parliamentary cycles;

POLICY ENGAGEMENT IN ACTION

HOW PRI SIGNATORIES CONDUCT POLICY ENGAGEMENT

When signing up to the Principles, signatories commit to annually reporting on their responsible investment activities through the PRI reporting and assessment framework. This helps signatories summarise and monitor their responsible investment activities, and provides feedback to enable continuous improvement. Our latest reporting cycle, carried out in 2021, included questions on policy maker engagement.[6] Its findings are summarised below.

MANY PRI SIGNATORIES ALREADY ENGAGE WITH POLICY MAKERS.

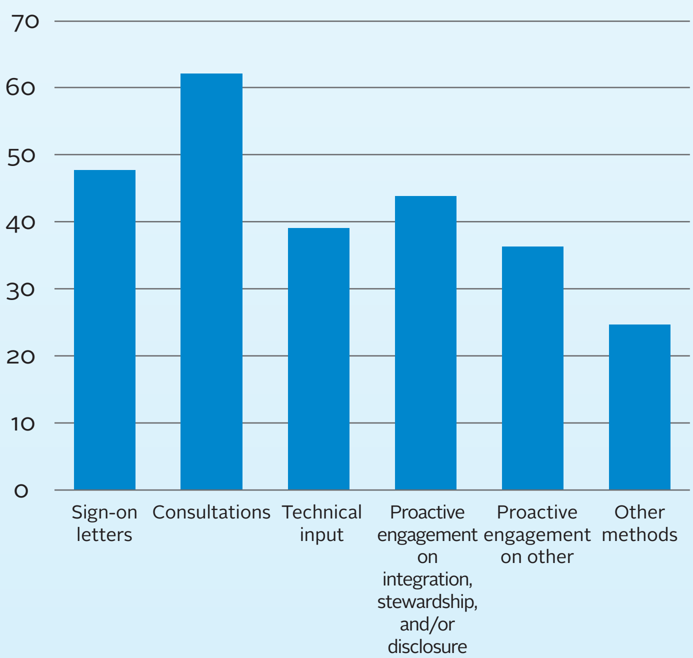
Of the 1927 signatories who could respond in 2021,

42% engaged with policy makers directly and

65% said they provided financial support, are members of or are otherwise affiliated with third-party organisations, including trade associations and non-profit organisations, that engage with policy makers.

Generally, asset owners (AOs) engage more than investment managers (IMs) and direct and indirect engagement by both increase with greater assets under management (AUM), likely due to greater resources available to larger managers.

PRI signatories use different methods to engage



NEVERTHELESS, THERE IS ROOM FOR PROGRESS.

1 in 4 signatories still do not conduct any form of policy engagement. Signatories with a lower AUM need support to start conducting policy engagement, particularly direct policy engagement.

BUT MORE EFFORT COULD BE MADE TO ENSURE ALIGNMENT BETWEEN ENGAGEMENT AND THE SIX PRINCIPLES

Almost

1 in 2 of the 1446 signatories who saw the relevant question said they did not have a policy in place to ensure alignment. AOs perform slightly better than IMs: 61% of asset owners have a policy engagement policy aligned with their position on sustainable finance and their commitment to the six Principles, whereas only 55% of investment managers do.

SIGNATORIES ENGAGING INDIRECTLY COULD ALSO BE MORE TRANSPARENT ABOUT THEIR ACTIVITIES

Of the signatories who said they engaged directly with policy makers, **73%** publicly disclosed these activities. Of those who engaged policy makers via a third-party, **53%** said they publicly disclosed this engagement. Finally, of those who engage directly and/or indirectly with policy makers, **24%** didn't publicly disclose their engagement at all.

6 Due to a tool error in the reporting framework for the 2021 reporting cycle, only a subset of signatories were able to see the questions referenced in this section (1927 for the top two boxes and the chart and 1446 for the two right hand boxes).

POLICY ENGAGEMENT BY INVESTOR INITIATIVES

Policy engagement is an essential complement to investor-investee engagement. Achievement of investors' sustainability goals is often impossible through investee engagement alone; companies that take action to address a sustainability issue may be placed at a competitive disadvantage to peers that are able to externalise the costs of unsustainable practices onto others.[7] Many collaborative stewardship initiatives recognise these limitations. Examples include the CA100+ initiative and Advance (see text box).

BOX 5: EXAMPLES OF COLLABORATIVE STEWARDSHIP INITIATIVES

THE CA100+ AND CLIMATE POLICY ENGAGEMENT

The Climate Action 100+ (CA100+) initiative is an investor-led initiative that aims to encourage the world's largest corporate greenhouse gas emitters to take necessary action on climate change. However, its goals can only be achieved if complemented by strong action from policy makers.

For example, it needs policy makers to set clear pathways or roadmaps to unlock systemic decarbonisation barriers across various industry sectors. It also requires clarity on financial regulation in order for investors to be able to sufficiently exercise their stewardship rights.

Policy engagement is also critical as an alternative and necessary stewardship tool for state-owned enterprises (SOEs), which have an outsized climate impact relative to listed companies. Only 15% of the companies on the CA100+ focus list are SOEs, but their proportional impact on the climate is much higher. According to the International Energy Agency, national oil companies account for more than 50% of global oil production (and an even higher percentage of reserves).[8]

Given the integration of SOEs within some national economies, and their influence on politics and employment, policy engagement is needed to ensure a just transition and to secure buy-in for enhanced climate ambition.

ADVANCE AND ENGAGEMENT FOR SOCIAL POLICY OUTCOMES

Advance is a new investor stewardship initiative, launched by the PRI in August 2022. Through the initiative, investors will use their collective influence with companies and other decision makers to take action on human rights and social issues.

Investor engagement with both companies and policy makers is required to pursue the objectives of this initiative. Key solutions to human rights issues require not only effective company stewardship by investors but also global regulatory solutions. Policy can help support global human rights aims both directly – e.g. with minimum wages and regulation to guarantee freedom of association – but also indirectly, through enabling of better governance, such as through mandatory due diligence legislation, protecting the voices of indigenous communities, the protection of voting rights for minority communities and the elimination of corruption and other forms of political capture.

Corporate political engagement that is not undertaken in a responsible manner[9] (including indirect activities) often undermines efforts to achieve global respect for human rights. Long-term universal investors have an interest in the political engagement of portfolio companies being aligned to their interests in regulation that protects human rights.

7 UNEP FI (2022). *The Future of Investor Engagement: A Call for Systematic Stewardship to Address Systemic Climate Risk.* https://www.unepfi.org/industries/investment/the-future-of-investor-engagement-a-call-for-systematic-stewardship-to-address-systemic-climate-risk/

8 See IEA (2022). 'Share of oil reserves, oil production and oil upstream investment by company type, 2018'. https://www.iea.org/data-and-statistics/charts/share-of-oil-reserves-oil-production-and-oil-upstream-investment-by-company-type-2018

9 See PRI's work on responsible political engagement: https://www.unpri.org/sustainability-issues/environmental-social-and-governance-issues/governance-issues/responsible-political-engagement

INVESTORS ENGAGING FOR POLICY REFORM

"Over the past few years, there has been a dramatic increase in the attention paid by financial policy makers to sustainability issues. Institutional investors have accompanied and, in some markets, led this change, via active engagement with these policy makers on sustainability issues. At Cardano, we see policy engagement as a Tier 1 form of influence, alongside collaborative engagement, co-filing and impact investment and, as such, a natural extension of our sustainability commitments. Improving the sustainability of the market as a whole, through well-designed sustainable investment policy reform, is much-needed and would bring clear benefits to our clients, the economy and society.

Cardano engages on both financial sector and real-economy policy where relevant to our sustainability commitments. As a recent example, Cardano has engaged on the UK Sustainability Disclosure Requirements, responding to the first consultation paper from the Financial Conduct Authority (FCA), contributing to working groups, and engaging with the FCA directly. We think the FCA's second consultation paper responds well to our feedback, will address greenwashing and will improve the sustainability of UK markets."

Cardano

"Responsible stewards are understanding how policy and regulatory change can help achieve their objectives, and are increasingly willing to go on the record and engage on policy issues. Investors in Aotearoa New Zealand actively advocated for TCFD disclosures, which resulted in New Zealand becoming the first country to mandate certain climate-related disclosures for publicly listed companies and large (Financial Markets Conduct Act-regulated) entities. This helps meet New Zealand's Paris Agreement commitments and helps investors price and value companies, as well as realign portfolios to contribute to a lower-carbon world."

Responsible Investment Association Australasia

"To stay abreast of policy issues, Octagon Credit Investors LLC is a member of the PRI's Global Policy Reference Group, subscribes to the PRI's Policy Newsletter, and is a part of the PRI's collaboration platform in an effort to provide feedback on industry policy issues and participate in other engagement efforts such as sign-on letters, as relevant to Octagon's business and when in the best interest of its clients. Octagon's approach to engaging with policy makers is primarily through indirect engagement as members of third-party organisations, such as the Loan Syndication and Trading Association and the PRI, that engage directly with policy makers."

Octagon Credit Investors LLC

"Neuberger Berman met with the Polish Ministry of Climate and the Environment to discuss the government's plans to address climate change, including the reduction of coal share in the energy mix. We highlighted our thermal coal policy for corporates and that it is only a matter of time before a sovereign coal policy is expected. While Poland's long-term plans are ambitious, further reduction of its coal reliance in a shorter timeframe would be beneficial in not losing access to climate financing. We found it to be constructive that the Ministry is communicating with investors proactively as Poland comes under more scrutiny due to its reliance on coal. We hold local currency bonds from Poland and remain keen to continue engaging the government further on coal reliance and other climate issues."

Neuberger Berman

"Sustainability is at the heart of everything we do, with the ambition to be the world's leading responsible asset manager. One of our main priorities is to play our role in the transition to a more sustainable world, which is a collective endeavour involving the financial sector, corporates but also policy makers.

In this perspective, we take an active role and engage with policy makers at global and regional levels on the responsible investing topic to bring our contribution to that growing critical debate – in the financial sphere and beyond, with all of our stakeholders. We want to ensure that the whole value chain related to RI contributes to achieving general interest and public policy goals with regards to the transition to a more sustainable world aligned with the goals of the Paris Agreement, while optimising our end-investors' needs and requests."

AXA Investment Managers

"Engaging with legislators, regulators and peers to discuss a framework for a carbon market in Brazil and the adequate vehicles to facilitate its financing has been critical. We have led a discussion group of PRI signatories who contributed with technical opinions to the Brazilian Securities and Exchange Commission and promoted debates and panels on carbon credit legislation and regulation in cooperation with stakeholders associated with the agribusiness and the industry associations. Today, all our stakeholders have a better understanding of carbon markets thanks to our efforts to share experiences and knowledge."

AGBI Real Assets

"The UK Stewardship Code expects investors to engage with regulators, policy makers and other stakeholders to improve the functioning of the financial markets and address systemic risks. The PRI's handbook is a useful guide to help investors focus their efforts and have the most impact."

UK Financial Reporting Council

"The rules that govern investment markets and the conduct of individual companies do not always operate in the best interests of long-term fiduciary asset owners and their beneficiaries. Asset owners have an opportunity and responsibility to engage with policy makers to better align the operation of the financial system with the interest of beneficiaries."

Australian Council of Superannuation Investors

"In order to promote net zero transition finance in Asia, we as responsible investors need to take into account regional specificities and enhance a collaborative engagement with policy makers more broadly."

Nippon Life Insurance

"Active ownership and stewardship by investors is a core foundation of JFSA's policies for revitalising capital markets, enhancing the competitiveness of industries and aligning corporate activities with long-term and sustainable goals. In doing so, investors must engage with policy makers so that visions for the sustainable future will be properly reflected in the policy framework and it will create proper incentives for corporates to address sustainability issues. We really hope that this report will guide investors for this purpose."

Japan Financial Services Agency

PRI PRIORITIES FOR POLICY REFORM

2022/23 PRIORITY AREAS FOR POLICY ENGAGEMENT

The PRI's current three-year strategy includes three objectives relevant to policy reform:

1. Engaging with policy makers on climate and other priority issues such as social issues, human rights and governance
2. Contributing to ESG incorporation being implemented in financial policy and regulation
3. Conducting legal and policy analysis to help develop the environment and frameworks needed to support investing for real-world outcomes

The PRI has identified key policy reform areas for engagement to support its signatories in their responsible investment practice. These priorities reflect the three overarching strategy objectives, and are informed by the PRI's views on the current policy agenda in each market and feedback from signatories.

Figure 7: Policy priorities in key markets

Jurisdiction	Policy priorities 2022/23
Australia	1. Clarify investors' duties to address sustainability-related systematic and systemic risks 2. Support the adoption of a comprehensive corporate sustainability reporting framework 3. Strengthen the regulatory framework for effective stewardship 4. Support the development and effective implementation of an Australian sustainable finance taxonomy 5. Support strong government action on climate change and modern slavery
Canada	1. Clarify investors' duties in pension fund regulation 2. Support the implementation of a credible 'made-in-Canada' sustainable finance taxonomy 3. Support the implementation of a comprehensive corporate sustainability reporting framework
China	1. Clarify investors' duties to consider sustainability-related risk and impacts 2. Support the adoption of a comprehensive corporate sustainability reporting framework 3. Strengthen the regulatory framework for effective stewardship 4. Support the development and effective implementation of a sustainable finance taxonomy for China 5. Advocate for a stronger policy framework for SDG and sustainability investment outcomes 6. Advocate for stronger action on climate change
European Union	1. Enhance operationality of the EU taxonomy framework, making it a central tool of EU sustainable finance policies and a prime example internationally 2. Implement sound mandatory ESG disclosure requirements for investors and corporates while increasing data consistency, reliability and comparability 3. Incorporate the Legal Framework for Impact findings into EU sustainable finance regulations and stewardship 4. Maintain leadership and support for sustainability policy reforms from key EU Member States (France, Germany) 5. Support ambitious climate-related policies reforms in the EU which have real-world impact for investors 6. Ensure ambitious social, human rights and governance policy reforms

Jurisdiction	Policy priorities 2022/23
Japan	1. Support the adoption of a comprehensive corporate sustainability reporting framework 2. Strengthen the regulatory framework for effective stewardship 3. Identify investor requirements for a taxonomy for sustainable activities and/or associated transition finance tools 4. Identify opportunities for clarification or guidance relating to investors' duties to support the pursuit of responsible investment for sustainability outcomes 5. Advocate for strong government action on climate change
United Kingdom	1. Support the development and effective implementation of a sustainable finance taxonomy 2. Support the adoption of a comprehensive corporate sustainability reporting framework 3. Identify opportunities for clarification or guidance relating to investors' duties to support the pursuit of responsible investment and sustainability outcomes 4. Strengthen the practices for effective stewardship 5. Advocate for strong government action on climate change 6. Ensure ambitious social, human rights and governance policy reforms
United States	1. Support access to consistent, comparable standardised issuer information on ESG issues 2. Clarify fiduciary duties to require investors to consider and integrate ESG issues in investment practices and processes 3. Strengthen the regulatory framework for effective stewardship via engagement and proxy voting 4. Advocate for Congress to pass legislation fully funding a clean energy standard or payment programme, extend existing clean energy tax credits, introduce funding and tax incentives for cross-state transmission infrastructure, create a methane reduction programme, and incentivise transportation electrification 5. Analyse minimum safeguards for decent work in the US and necessary gaps to fill to ensure basic protections for workers

PRI POLICY RESOURCES

The PRI supports its signatories to better understand and contribute to effective, ambitious and coherent financial policy reform. The policy resources developed by the PRI can complement and inform direct signatory policy engagement. They can also be used by signatories who do not have dedicated policy resources in place.

OUR POLICY APPROACH

The PRI actively engages with public policy where relevant to our Principles and Mission, as outlined in our policy approach. In doing so, the PRI:

- will respond to policy consultations, where relevant;
- will not seek to represent the views of the whole signatory base or indicate that research or recommendations represent the views of signatories collectively;
- will base its comments on high-quality research containing well-considered arguments and proposals that are rigorously defendable; and
- may make recommendations for policy makers.

POLICY PUBLICATIONS

All policy publications are available at www.unpri.org/policy, including:

- policy reports and briefings;
- foundational reforms, including a policy toolkit;
- flagship research on the Legal Framework for Impact and Fiduciary Duty;
- responses to policy consultations and letters sent to policy makers;
- the PRI regulation database, compiling responsible investment policies and regulations across more than 100 markets; and
- a collaboration platform with links to all ongoing policy consultations.

GLOBAL POLICY REFERENCE GROUP

The PRI hosts a Global Policy Reference Group.
The group aims to:

- inform and strengthen public policy engagement on responsible investment topics by the PRI and our signatories;
- encourage greater alignment between our signatories' responsible investment commitments and public policy efforts; and
- ultimately create a regulatory environment aligned with the PRI's Mission and six Principles.

The group is first and foremost an email exchange of information on policy, regulation and soft-law initiatives that encourage or require responsible investment. All email exchanges are confidential and should not be forwarded. Policy professionals at PRI signatories are welcome to join the group. The current membership and terms of reference are listed on our advisory committee page.

POLICY NEWSLETTER

The PRI publishes a monthly policy newsletter – subscribe here.

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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

UN environment programme | 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