PRI | Principles for Responsible Investment

July 12, 2023

Chair Patrick McHenry
Ranking Member Maxine Waters
Members of the Committee
U.S. House Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

Dear Chair McHenry, Ranking Member Waters and Members of the Committee,

The Principles for Responsible Investment (PRI) welcomes the opportunity to submit this statement for the record for the Committee on Financial Services hearing entitled, "Protecting Investor Interests: Examining Environmental and Social Policy in Financial Regulation."

The PRI is the world's leading initiative on responsible investment. We work to support investors in discharging their fiduciary duty by furthering the development of best practice on responsible investment, and helping our signatories understand how they can incorporate these practices to achieve their investment goals. Launched in 2006, the PRI now has more than 5,300 signatories globally (including asset owners such as pension funds and insurers, investment managers, and service providers) representing approximately $121 trillion in assets under management.[1] The PRI has more than 1,000 signatories based in the US.[2]

The Committee's attention on responsible investment issues is welcome and timely, as investors continue their efforts to adapt to an increasingly complex and quickly changing world. The industry is evolving its practices to account for the investment considerations affected by environmental, social and governance factors. These factors can significantly influence the financial risks and returns of their investment portfolios. As such, it is increasingly important to ensure investors have access to decision-useful information on related business activities that is consistent, comparable and standardized. This includes tools for consideration of all material data points to make informed investment decisions, reduce portfolio risk and meet the goals of their clients and beneficiaries. Investors also require the ability to express their rights as shareholders by carrying out robust stewardship programs—including via the proxy voting process—to fulfil their fiduciary duties to maximize returns.

Twice previously, in July 2019 and February 2021, the Committee held similar hearings and the PRI provided our perspective on the importance of supporting investors in their responsible investment practices.[3] In each of these prior letters, we highlighted the financial materiality of ESG factors, the necessity of consistent, comparable disclosure from issuers and the clarity needed for investors.

[1] As of July 6, 2023.
[2] An overview of the PRI's signatories is available on the PRI website: https://www.unpri.org/signatories/signatory-resources/signatory-directory.
[3] PRI, Letters to the Subcommittee on Investor Protection, Entrepreneurship and Capital Markets (February 25, 2021), available at: https://dwtyzx6upklss.cloudfront.net/Uploads/h/t/j/pri_statement_for_the_record_hfsc_hearing_2_25_487426.pdf; and (July 10, 2019), available at: https://d8g8t13e9vf2o.cloudfront.net/Uploads/p/p/l/pricommenthfscesghearingfinal_765719.pdf.

Responsible Investment Supports Fiduciary Duties

Responsible investment—including ESG integration—is not a new practice but has grown steadily in use and recognition over the past 50 years.[4] These topics have garnered increased attention as the materiality of ESG factors and relevance of responsible investment practices have become clearer, especially following the global COVID-19 pandemic. Responsible investment is a necessary evolution which enhances traditional financial analysis and portfolio construction techniques by considering financial risks and opportunities that may not be appropriately priced by the market. This involves broadening the perspective of an investor's decision-making to better account for all potentially relevant information that could impact the risk-return profile of investment decisions.

Responsible investment in no way forces investors to include or exclude specific investments, overweight specific considerations, or stray from their duties to clients and beneficiaries. There is no one way to be a responsible investor. Investors can use ESG information in many different ways throughout their investment and stewardship decisions. Incorporating material ESG information aids investors in making sure they are not ignoring or underweighting financially material issues when assessing risk and return. Depending on investment objectives, investors may apply an ESG-related process to their entire portfolio, on particular asset classes or on certain products. Different investors employ various strategies, leaving the choice of strategy up to the asset owner's (client's) decision.

Responsible investment practices support fiduciary duty by working to improve governance, disclosure and transparency across financial markets. As part of their responsibilities, fiduciaries consider risks, trends, opportunities and time-horizon (both short-term and long-term) when making investment decisions. The duties of prudence and loyalty are the inviolable core of every investor's responsibility. By advocating for stronger governance and transparency across financial markets, responsible investment supports participants at every level of the financial system to better assess actions both up and down the investment chain.

Environmental, Social and Governance Factors Are Material

ESG encompasses a broad range of overlapping factors that can influence the financial risk and return characteristics of an investment. ESG factors cover many different aspects, from climate change and resource scarcity (E) to working conditions and human rights violations (S) to bribery/corruption and executive compensation (G). These factors are used in investment analysis as better data show their increasingly material nature.[5] Growing attention to ESG reflects investors working diligently to ensure material risks and opportunities are appropriately assessed in order to protect and deliver for clients.

ESG integration is not an investment strategy, per se, but rather a process for formally considering a range of potentially material factors, for a more comprehensive understanding of financial risk and return. For example, an investor might consider that the increasing frequency and magnitude of drought in the Midwest poses a material risk to existing crop production and may lower productivity in the short- and potentially long-term, thus rendering some investments less appealing. Investors must be equipped with the tools and information to consider financially material factors like these when making investment decisions, or risk missing insights that can help deliver optimized risk-adjusted returns for their clients.

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[4] PRI, Introductory Guides to Responsible Investment: What is responsible investment? (2022), available at: https://www.unpri.org/introductory-guides-to-responsible-investment/what-is-responsible-investment/4780.article.
[5] PRI, Top academic resources on responsible investment (July 2023), available at: https://www.unpri.org/research/top-academic-resources-on-responsible-investment/4417.article.

Rather than reflecting political bias, consideration of ESG factors becoming a fundamental part of investment practice is evidence of free markets working. ESG integration allows investors to incorporate insights into how companies are considering and responding to issues that can materially impact their success, both over the short and long-term. For example, the shift in investment flows from a carbon-intensive to a low-carbon economy represents both investment risk and opportunity, in terms of stranded assets and emergence of new technologies. Investors failing to respond to these changes risk missing out on potentially material insights and may be violating their fiduciary duties.[6]

Investors Require Access to Tools

Responsible investment practices—including ESG integration—are a necessary evolution of investment practice in response to new knowledge (like the evidence of the rapid advancement of impacts from human-caused climate change) and client demand. Fiduciary duties require investors to build new tools and develop new processes to accurately assess potentially material information.

Efforts to limit how investors can independently consider information can prove costly by imposing administrative burdens, limiting an investor's window into financial markets and narrowing the investible universe.[7] Vague guidelines can also create additional liability as one person's interpretation of "pecuniary", for example, can differ from the next.[8] Differing interpretations of what information is material is not an issue to be resolved, but rather the foundation of competitive financial markets where investors compete for better insights from combinations of information that provide better assessments, and better returns. As such, efforts to restrict or otherwise influence what information investors consider can have broad, unintended consequences on market efficiency, valuations and returns.

Introducing new vague or weighted language can be seen as an attempt to interfere with investor decision-making; to underweight or ignore material information, or artificially limit investment timeline or scope.[9] This is reflected in the PRI[10] and 97% of public commenter support for the Department of Labor's proposed rulemaking, "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights"[11] which removed "pecuniary" language from its regulations. It is also reflected in the vocal opposition from the professional investment community to similar efforts in state legislatures' 2023 sessions.[12] Instead, investors require the support of regulators and lawmakers as they work to fully assess potentially material information, in an objective way, to chart the best course of action for clients.

[6] David Atkin, PRI Blog: "Criticizing ESG incorporation does not make it any less essential (July 25, 2022), available at, https://www.unpri.org/pri-blog/criticising-esg-incorporation-does-not-make-it-any-less-essential/10288.article.

[7] Freedom to Invest, Economic Impacts (2023), available at: https://www.freedomtoinvest.org/economic-impacts/.

[8] David H. Webber, David Berger, and Beth Young, Harvard Law School Forum on Corporate Governance, "The Liability Trap: Why the ALEC Anti-ESG Bills Create a Legal Quagmire for Fiduciaries Connected with Public Pensions (February 27, 2023), available at: https://corpgov.law.harvard.edu/2023/02/27/the-liability-trap-why-the-alec-anti-esg-bills-create-a-legal-quagmire-for-fiduciaries-connected-with-public-pensions/; and Karen Tyler, Commissioner, North Dakota Securities Department, comments before the North Dakota House Committee on Industry, Business and Labor (February 6, 2023), available at: https://video.ndlegis.gov/en/PowerBrowser/PowerBrowserV2/20230206/-1/28863.

[9] PRI, "Consultation Response: U.S. Department of Labor: Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights" (December 13, 2021), available at: https://dwtyzx6upklss.cloudfront.net/Uploads/g/n/l/pricommentrin1210ac03_138307.pdf; and "Consultation Response: U.S. Department of Labor: Fiduciary Duties Regarding Proxy Voting and Shareholder Rights" (October 5, 2020), available at: https://dwtyzx6upklss.cloudfront.net/Uploads/d/h/r/pricomment_dolfiduciarydutiesreproxyvotingandshareholderrightsrin1210ab91_20956.pdf; and "Consultation Response: U.S. Department of Labor: Financial Factors in Selecting Plan Investments" (July 30, 2020), available at: https://dwtyzx6upklss.cloudfront.net/Uploads/f/n/b/pricomment_dolerisaproposedrule30july2020_986374.pdf.

[10] US SIF, "Blog: Public Comments Overwhelmingly Support US Labor Department Proposal To Allow ESG Considerations In Retirement Plans" (January 26, 2022), available at: https://www.ussif.org/blog_home.asp?display=182.

[11] U.S. Department of Labor, Employee Benefits Security Administration, "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights – Proposed Rule" (October 13, 2021), available at: https://www.dol.gov/agencies/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AC03

[12] Pleiades Strategy, "2023 Statehouse Report: Right-Wing Attacks on the Freedom to Invest Responsibly Falter in Legislatures" (2023), available at: https://drive.google.com/file/d/1t38kmUxWFK43NZQxc-m_EbQADUk8cbPb/view.

Investors Require Access to Information

Transparency sits at the heart of responsible investment. The PRI advocates for increased disclosure of corporate and investor practices so the market can better assess the actions of market participants.

In response to the growing understanding of the materiality of ESG-related factors, investors require additional information from companies. A significant amount of ESG-related information is already known or easily compiled by companies. For example, energy and water bills provide a starting point for disclosing natural resource use. Employee demographic information is already compiled and reported to the Equal Employment Opportunity Commission but is not available publicly. In 2021, 96% of the S&P 500 and 81% of the Russell 1000 produced sustainability reports (up from 20% in 2011).[13]

Globally, financial markets continue to align on the material corporate ESG-related information they find most informative. This makes it easier for investors to gather the insights needed and more efficient for companies to disclose a consistent set of information in an increasingly comparable way.

For example, investor demand for climate-related information is increasingly aligned globally.[14] The IFRS Foundation—which sets accounting standards for 140 jurisdictions—recently published its draft baseline of climate-related disclosure which also draws from the US-founded Sustainability Accounting Standards Board (SASB) that merged with IFRS in 2022.[15] Additional efforts to establish baselines for other ESG-related issues are underway.[16] The SEC's proposed rule, "The Enhancement and Standardization of Climate-Related Disclosures for Investors"[17] aligns closely with the work of the IFRS Foundation and Taskforce on Climate-Related Financial Disclosures, among other global initiatives, and would support investor needs on material climate-related information.[18]

More broadly, the basic expectations for companies to protect human rights and operate responsibly were laid out more than a decade ago by the United Nations and OECD, respectively.[19] Just as ESG is not a new consideration for the financial sector, increased expectations for business conduct and related disclosure has been growing for decades. For example, the United Nations Global Compact (UNGC) has for more than 20 years sought to align businesses around 10 core principles of responsible business on human rights, labor, the environment and anti-corruption. UNGC has more than 1,000 signatories based in the United States.[20]

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[13] Governance & Accountability Institute, Inc., "All-Time High of Sustainability Reports Among U.S. Publicly-Traded Companies" (2022), available at: https://www.ga-institute.com/research/ga-research-directory/sustainability-reporting-trends/2022-sustainability-reporting-in-focus.html.

[14] Task Force on Climate-Related Financial Disclosures, "TCFD Recommendations" (June 2017), available at: https://www.fsb-tcfd.org/recommendations/.

[15] IFRS Foundation, Climate-related Disclosures: "IFRS S2 Climate-related Disclosures" (June 26, 2023), available at: https://www.ifrs.org/projects/completed-projects/2023/climate-related-disclosures/#published-documents.

[16] Taskforce on Nature-related Financial Disclosures, "About", available at: https://tnfd.global/about/.

[17] U.S. Securities and Exchange Commission, "The Enhancement and Standardization of Climate-Related Disclosures for Investors", (April 11, 2022), available at: https://www.federalregister.gov/documents/2022/04/11/2022-06342/the-enhancement-and-standardization-of-climate-related-disclosures-for-investors.

[18] PRI, "Consultation Responsible: Securities and Exchange Commission File No. S7-10-22: The Enhancement and Standardization of Climate-Related Financial Disclosures for Investors" (June 17, 2022), available at: https://dwtyzx6upklss.cloudfront.net/Uploads/x/d/z/pricomment_secclimaterelateddisclosures_423012.pdf; and PRI signatory letter on the SEC's Request for Comment on Climate Change Disclosure (June 11, 2021), available at: https://dwtyzx6upklss.cloudfront.net/Uploads/g/q/m/priclimatedisclosuresignatorysignonletter_15524.pdf; and PRI signatory letter to SEC Chair Gensler on the proposed rule (November 1, 2022), available at: https://dwtyzx6upklss.cloudfront.net/Uploads/h/o/l/priletter_climatedisclosurerulefinal_480083.pdf.

[19] United Nations, Office of the High Commission on Human Rights, "Guiding Principles on Business and Human Rights" (2011), available at: https://www.ohchr.org/sites/default/files/documents/publications/guidingprinciplesbusinesshr_en.pdf; and OECD, "OECD Guidelines for Multinational Enterprises on Responsible Business Conduct (September 29, 2011, updated June 8, 2023), available at: https://mneguidelines.oecd.org/mneguidelines/.

[20] United Nations Global Compact (2023), available at: https://unglobalcompact.org/.

The PRI similarly supports disclosure from investors and the financial sector. Since its launch in 2006, the PRI has grown into the largest responsible investment reporting initiative globally with thousands of investors completing the Reporting Framework annually.[21] The Reporting Framework provides transparency and accountability on signatory responsible investment practices, allowing investors, clients and the market to compare practices year-over-year. The PRI continuously looks to improve the reporting process to be more efficient for reporters and useful for the market.

Progress continues to be made in efforts to provide retail investors, asset owners and market participants better disclosure from investment managers and funds. In 2022, the SEC finalized improvements to Form N-PX, the annual form required by all investment funds detailing proxy voting activities.[22] These improvements made the proxy voting process more transparent, providing more consistent and comparable data in a searchable, accessible, organized and efficient format.[23]

Further, the PRI supports the SEC's proposed rule "Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices"[24] to address greenwashing by improving the information provided by investment managers. This will support retail investors to better understand the products they are purchasing.[25] The PRI similarly supports the SEC's proposed amendments to the Investment Company Names rule to ensure a fund's name—the most prominent disclosure of a fund—matches the underlying assets within that fund. These proposals seek to ensure that investment manager activities reflect their accompanying public disclosures; essentially, that investors know what their managers are doing on their behalf.[26] These improvements represent the natural, and necessary, evolution of the SEC's disclosure regime designed to, primarily, protect investors and, secondarily, maintain fair, orderly and efficient markets.[27]

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[21] PRI, The Reporting Process, "Investor Reporting Framework" (24 May 2023), available at: https://www.unpri.org/reporting-and-assessment/investor-reporting-framework/5373.article.
[22] U.S. Securities and Exchange Commission, "Final Rule: Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers" (November 2, 2022), available at: https://www.sec.gov/rules/final/2022/33-11131.pdf.
[23] PRI, "Consultation Response: Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers; File Number S7-11-21" (December 14, 2021), available at: https://dwtyzx6upklss.cloudfront.net/Uploads/w/v/c/priconsultation_formnpx_442144.pdf.
[24] U.S. Securities and Exchange Commission, "Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices", (June 17, 2022), available at: https://www.federalregister.gov/documents/2022/06/17/2022-11718/enhanced-disclosures-by-certain-investment-advisers-and-investment-companies-about-environmental.
[25] PRI, "Consultation Response: Securities and Exchange Commission File No. S7-17-22: Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices" (August 16, 2022), available at: https://dwtyzx6upklss.cloudfront.net/Uploads/b/o/x/prifinaladviserfunddisclosurerule_973433.pdf.
[26] PRI, "Consultation Response: Securities and Exchange Commission File No. S7-16-22: Investment Company Names" (August 16, 2022), available at: https://dwtyzx6upklss.cloudfront.net/Uploads/b/o/x/fundnamesrule_pri_secfileno.s71622_766843.pdf.
[27] U.S. Securities and Exchange Commission, "About the SEC" (April 6, 2023), available at: https://www.sec.gov/strategic-plan/about.

Shareholder Rights Must Be Protected

The rights attributed to shareholders in public companies are the core agreement that drives US financial markets—the deepest and most liquid in the world.[28] Investors exercise their rights as shareholders on material ESG-related issues in the same way, and for the same reasons, they exercise these rights on other issues: to encourage high standards of performance in the companies and entities in which they invest as part of a long-term investment strategy. Their enhanced scrutiny of corporate management on ESG risks and opportunities stems from the fundamental desires of investors to protect value and maximize risk adjusted returns.

The concerns raised by the ESG Working Group[29] regarding shareholder rights—specifically the proxy voting process—reiterate those proffered by the SEC in 2020 in its rulemakings, "Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8"[30] and "Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice".[31]

The PRI opposed both above referenced proposals as they were built upon similar inaccurate assessments of the proxy voting process.[32] Voting proxies is an effective tool that investors use to engage with investee company management and to share views and expectations. Many institutional investors recognise proxy voting as part of their fiduciary duty to clients because it can be used to influence corporate behavior, and thus, returns.

The SEC's changes to Rule 14a-8 made it more difficult for shareholders to submit proxies for a vote despite evidence that the rule would disproportionately harm retail investors, those traditionally least able to have their views heard.[33] As the underlying owners of corporate entities, shareholders should maintain the ability to engage with management on material issues and to escalate those engagements to public votes when deemed necessary.[34]

Similarly, as the PRI stated to the SEC in 2020, "proxy advisory firms conduct the important and necessary work of providing high quality, independent analyses, linking [analysis] to voting recommendations based on institutional investors' stated priorities. Many institutional investors use proxy advisory firms' recommendations to supplement their research and understanding of multiple, detailed, and sometimes dense proxies for their portfolio."[35] Efforts to interfere with this customer-client relationship would limit the important market efficiencies gained by these services and impose increased costs on investment managers least able to afford them.

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[28] SIFMA, "Research Quarterly: Equities" (April 28, 2023), available at: https://www.sifma.org/resources/research/research-quarterly-equities/#:~:text=The%20U.S.%20equity%20markets%20are,the%20next%20largest%20market%2C%20China.

[29] ESG Working Group, House Committee on Financial Services, "Preliminary Report on ESG Climate Related Financial Services Concerns" (June 23, 2023), available at: https://financialservices.house.gov/uploadedfiles/hfsc_esg_working_group_memo_final.pdf.

[30] U.S. Securities and Exchange Commission, "Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8" (November 4, 2020), available at: https://www.federalregister.gov/documents/2020/11/04/2020-21580/procedural-requirements-and-resubmission-thresholds-under-exchange-act-rule-14a-8.

[31] U.S. Securities and Exchange Commission, "Exemptions From the Proxy Voting Rules for Proxy Voting Advice" (September 3, 2020), available at: https://www.federalregister.gov/documents/2020/09/03/2020-16337/exemptions-from-the-proxy-rules-for-proxy-voting-advice.

[32] PRI, Letter from PRI, select signatories and supporting organizations on "File numbers: S7-23-19; S7-22-19" (February 3, 2020), available at: https://d8g8t13e9vf2o.cloudfront.net/Uploads/q/h/l/secsignonletter_pri_february32020_907833.pdf.

[33] PRI, et al. "Letter Re: Improper Exclusion of Evidence on the Impact of the Proposed Amendments to Rule 14a-8 on Retail Investors" (September 4, 2020), available at: https://dwtyzx6upklss.cloudfront.net/Uploads/x/u/o/groupcommentletteronimproperlyexclusionofevidenceonimpactonretailinvestors_136927.pdf.

[34] PRI, "File Number: S7-23-19: Proposed Rule: Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8" (February 3, 2020), available at: https://d8g8t13e9vf2o.cloudfront.net/Uploads/q/h/l/pris72319_february032020_882134.pdf.

[35] PRI, "File Number S7-22-19: Proposed Rule: Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice" (February 3, 2020), available at: https://d8g8t13e9vf2o.cloudfront.net/Uploads/q/h/l/pris72219_february032020_623133.pdf.

Like any third-party recommendation to an independent business, it is up to that business to determine when and how to utilize the third-party advice to achieve its goals. Investment managers are ultimately responsible for conducting due diligence on third-party advisory services and ensuring their proxy voting policies are implemented correctly.

Progress has been made on better serving shareholders in the proxy voting process with the approval of the SEC's requirement of universal proxy cards. Universal proxies will ensure that shareholders have equal access to the full slate of candidates for director positions.[36] We should look toward similar efforts as this where efficiencies can provide better information to market participants and support the underlying purpose of capital markets: to provide long-term, sustainable returns for investors.

Should you or any members of the Committee like to discuss these comments further or how the PRI can support your work on other issues, please do not hesitate to contact our policy team at policy@unpri.org.

Sincerely,

David Atkin

Chief Executive Officer, Principles for Responsible Investment

[36] PRI, "Consultation Response: Securities and Exchange Commission: Reopening of Comment Period on Universal Proxy" (June 7, 2021), available at: https://dwtyzx6upklss.cloudfront.net/Uploads/l/t/a/priuniversalproxyconsultation7june_977493.pdf.