PRI RESPONSE TO THE ISRAEL SECURITY AUTHORITY CALL FOR PROPOSALS ON CORPORATE RESPONSIBILITY AND ESG RISK DISCLOSURES

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INTRODUCTION

The United Nations-backed Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI has over 3000 signatories (pension funds, insurers, investment managers and service providers) globally with approximately US $90 trillion in assets under management. Responsible investment explicitly acknowledges the relevance to the investor of environmental, social and governance (ESG) factors in investment decision-making for the long-term health and stability of financial markets. The PRI welcomes the opportunity to contribute evidence to the Israel Securities Authority (ISA) Call for Proposals on Corporate Responsibility and ESG risk disclosures.

PRI, העקרונות להשקעה אחראית המגובים על ידי האו"ם, היא היוזמה המובילה בעולם בתחום ההשקעות האחראיות. על היוזמה חתומים מעל 3000 גופים (קרנות פנסיה, מנהלי השקעות ונותני שירותים בתחום) מכל העולם המנהלים נכסים בשווי 90 מיליארד דולר בקירוב. תפיסת ההשקעות האחראיות מכירה בחשיבותם של גורמי סביבה, חברה וממשל תאגידי (ESG), ובהשפעתם על חסינות ויציבות השווקים הפיננסיים בטווח הארוך ועל תהליכי קבלת החלטות של משקיעים. ה-PRI מברכת על ההזדמנות לספק מידע וראיות לקול הקורא של הרשות לניירות ערך בעניין גילוי אודות אחריות תאגידית וסיכוני ESG.

ההמלצה העיקרית של ה-PRI היא שהמסגרת שהרשות לניירות ערך מפתחת לטובת גילוי אודות ESG תקיים מספר עקרונות:

- **גילוי ESG יחייב את כל החברות הרשומות בבורסה הישראלית**
- **המידע המדווח יכלול נתונים וניתוח של היבטי ממשל תאגידי, אסטרטגיה, סיכונים ומדדים כפי שמוצע במסגרת ה-TCFD**
- **גילוי ESG יוצג יחד עם גילוי המידע הפיננסי – על פי אותו פורמט, באותן מערכות, ובאותם לוחות זמנים**
- **הגילוי יבוצע בכפוף לסטנדרט אחיד שיאפשר השוואה בין חברות, כך שמשקיעים יוכלו להשתמש במידע בהערכות הסיכונים שלהם**
- **הרשות לניירות ערך תשתתף בדיון ותתרום למאמצים הגלובליים לסטנדרטיזציה של גילוי ESG בין מדינות**

אימוץ עקרונות אלו יניח יסודות לבניית מערכת פיננסית יציבה ובת קיימא שתהלום מטרות גלובליות המקדמות היבטי אקלים וקיימות.

SUMMARY

Investors around the world view ESG issues as material to their investment decision making processes. Investors are also subject to increasing regulatory requirements and policy measures that support, encourage or require investors to consider long-term value drivers, including ESG issues.[1] Failing to consider these is failing their fiduciary duty.[2]

Sustainable investment policy, and transparency over ESG performance, are receiving additional attention as governments and policymakers discuss how to rebuild their economies in the wake of the COVID-19 pandemic. The pandemic has put many aspects of the global economy on hold, highlighting the social and economic consequences of inequality. The pandemic has not, however, stopped the climate emergency and will not prevent the risks from extreme weather events and other climate-related shocks that threaten us now and in future.

According to the ISA's 2019 report on participation of international investments in Israel, the Israeli market has suffered from a decline in international investments after MSCI changed its classification from MSCI Emerging markets to MSCI world in 2010. This classification brings with it a set of expectations and the reduction in passive investments means that attracting active foreign institutional investors is more important than ever.[3]

In Israel, many companies already engage in ESG disclosure through various frameworks. This includes general independent ESG reports, ESG reports tailored for individual investors and/or reporting via voluntary frameworks such as the local Maala questionnaire, GRI, CDP, UN Global Compact, The Israel Ministry of Environmental Protection's voluntary carbon disclosure and ISO. The Government Companies Authority in Israel has also issued a letter to governmental companies allowing them to report according to the GRI methodology to fulfil their obligation to create a sustainable development policy. While these endeavours have been positive in supporting companies' understanding of ESG measuring and disclosure, they do not provide standardised, comparable information for investors.

The Israeli market is ready for a mandatory, standardised ESG disclosure policy framework, with a requirement to disclose ESG data and analysis by all listed companies in a comparable, aggregable, consistent manner, together and in the same format as financial information disclosure. For companies listed in the Israeli stock market this will not only reduce the reporting burden (where companies already report through several frameworks) but will also add value by providing investment-grade information on their corporate performance to local and global investors.

Introducing a mandatory ESG disclosure requirement for listed companies will put Israel in line with countries around the world which are developing sustainable investment policies, including on corporate ESG disclosure. This is also an opportunity for Israeli policymakers to contribute to the global efforts of creating a sustainable and inclusive financial system.

[1] https://www.unpri.org/policy/regulation-database
[2] https://www.unpri.org/fiduciary-duty-in-the-21st-century-final-report/4998.article
[3] http://www.isa.gov.il/GeneralResearch/179/Documents/International_investments_in_israel.pdf

PRI'S RESPONSE TO THE CONSULTATION

The PRI's key recommendation is that the Israel Securities Authority should develop an ESG disclosure framework with the following features:

- ESG disclosure should be mandatory for all listed companies in the Israeli Stock Exchange.
- The disclosed information should include data and analysis on governance, strategy, risk, and metrics as suggested by the TCFD framework.
- ESG disclosure should be presented together with financial data, based on the same scope, within the same systems and according to the same timelines.
- The disclosed information should be standardised and aligned with international frameworks.
- The ISA should engage in global efforts to standardise ESG disclosure across countries.

Adopting such measures will lay the groundwork for building a sustainable financial system, aligned with global sustainability and climate goals.

1. IS THERE A NEED FOR DISCLOSURE ON ESG MATTERS, AND IF SO, WHICH MATTERS SPECIFICALLY?

האם יש צורך בגילוי בנושאי **ESG** ואם כן, באיזה נושאים באופן ספיציפי?

Empirical and academic evidence demonstrates that incorporating ESG issues is a source of investment value. ESG analysis assists investors to identify value-relevant issues. Neglecting ESG analysis may cause the mispricing of risk and poor asset allocation decisions and is therefore a failure of fiduciary duty.[4]

Corporate ESG disclosures include quantitative and qualitative ESG data and analysis on companies' sustainability performance. ESG data and analysis have many uses in the investment process:

- Integration in valuation models, alternative beta, quant, factor and index investing
- Integration in credit research and assessments
- Screening (positive, negative and exclusions based)
- Producing ESG 'best in class' approaches (ESG ratings)
- Thematic investment (allocating capital to environmental or social outcomes)
- Creating and monitoring funds with specific environmental and/or social characteristics
- Measuring the impact of companies and/or funds (portfolio monitoring, carbon foot-printing)
- Active ownership, stewardship, engagement
- Communicating with clients and beneficiaries

Basic ESG disclosures include core issues and metrics common to all listed companies in a given market, such as CO2 emissions, health and safety, turnover, number of women in managerial positions etc.[5] The disclosed ESG data should be analysed and explained in comparison to sectoral averages and historical performance.

In addition, ESG disclosure requirements can include:

- industry-specific and activity-based disclosures including sector and activity-relevant material ESG issues;
- corporate accountability on general economic contribution (including taxes, wages, local development and investment);

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[4] https://www.unpri.org/fiduciary-duty-in-the-21st-century-final-report/4998.article
[5] See as an example https://www.unpri.org/fiduciary-duty/esg-data-in-china-recommendations-for-primary-esg-indicators/4345.article

- context-based performance assessment of ESG disclosure and targets to show how Chinese companies are aligning their strategies with globally agreed sustainability goals;
- forward-looking and scenario-based ESG disclosures, in alignment with the TCFD framework.

Corporate ESG disclosure is a prerequisite for responsible investment, and the lack of standardised, meaningful ESG data is a major barrier for investing sustainably. Across markets, regardless of policy requirements, companies tend to report on similar ESG topics through their voluntary disclosures. But when ESG disclosure regulations are not mandatory and standardised, the resulting ESG data is incomplete and not readily comparable across markets, industries and portfolios. The need for comparability of ESG performance of assets across portfolios, industries and markets requires that corporate ESG disclosures are regulated and standardised on national and international level.

Requiring ESG disclosure for all listed companies in Israel will support:

- the provision of useful information to both Israeli and international investors to make investment decisions by integrating standard ESG data;
- enhanced management and board oversight of performance on key ESG issues within listed companies;
- and increasing investment in green and sustainable assets.

Incorporating data and analysis on ESG issues in investment strategy, policy decisions and active ownership is regarded by investors and policy makers as part of their fiduciary duty. Corporate reporting on sustainability/ESG issues, facilitates a range of investor decision making:

- identify opportunities, such as through changes to business models, across supply chains and through new and expanded products and services
- prepare for and respond to legal and regulatory developments, including those that may lead to asset stranding
- protect their reputation and licence-to-operate, particularly in the event of negative outcomes from investments
- meet institutional commitments to global goals (including those based on client or beneficiaries' preferences), and communicate on progress towards meeting those objectives
- consider materiality over longer time horizons, to include transition risks, tail risk, financial system risks etc
- minimise negative outcomes and increase positive outcomes of investments.

2. IF ESG DISCLOSURES ARE WARRANTED, WHAT IS THE APPROPRIATE FORMAT FOR THE DISCLOSURES?

מהי מתכונת הגילוי המתאימה בהקשר זה?

There are four common components to ESG disclosure policies: governance, strategy, risk, and metrics. The TCFD framework is a good example from which regulators can develop their disclosure policy frameworks. These features can be found in most of the existing independent disclosure frameworks, as well as in national or stock exchange led disclosure regulations.

Furthermore, specific issues that are deemed relevant from an Israeli perspective such as water scarcity could be introduced additionally.

3. IF ESG DISCLOSURES ARE WARRANTED, SHOULD THE DISCLOSURE BE VOLUNTARY OR COMPULSORY (BY LAW)?

האם גילוי זה צריך להיות וולונטרי או מנדטורי (מכוח הוראת דין)?

ESG issues are financially material and disclosure on ESG data and analysis should be mandatory for all companies. This will allow investors to incorporate material information in investment decision making. Disclosure requirements can also include comply-or-explain elements, which can be further updated to mandatory as market practice and international alignment on ESG disclosure develop.

Evidence demonstrates that mandatory disclosure regulations are more impactful than voluntary guidelines and can also create market efficiencies, as today companies are responding to multiple voluntary frameworks. Mandatory regulation will not only help to codify terminology (for greater consistency), it will also level the playing field on existing best disclosure practices rewarding first movers and the best social and environmental performers. Market-wide disclosures will also level the playing field for Israeli companies on international level. Voluntary, non-standardised disclosures do not provide adequate information to investors in terms of scope, comparability and quality.

4. WHERE SHOULD THE DISCLOSURE BE LOCATED (E.G. THE COMPANY'S WEBSITE. THE MAGNA SYSTEM IN WHICH COMPANIES' REPORTS ARE CONCENTRATED OR A DESIGNATES WEBSITE FOR ESG DISCLOSURE)

מהו מיקומו הרצוי?

From the perspective of investors, standardised ESG disclosure should be located in the same place financial data is reported i.e. the MAGNA system. This will provide investors with all relevant information to consider around their investment. ESG disclosures should be made accessible to all investors (available free of charge, accessible online and available in a timely manner).

ESG disclosures should be published alongside financial indicators, based on the same reporting scope. Such data should also be published in corporate annual reports, under the supervision of the board and should be linked to companies' business models, their corporate strategy (including financial and sustainability objectives and thresholds) and risk factors.

5. DO LISTED COMPANIES SPECIFICALLY WARRANT ESG REQUIREMENTS?

האם יש הצדקה לגילוי דווקא מחברות הנסחרות בבורסה?

The ISA requires that public companies disclose all information that is material for investors to be able to make investment decisions. The former President of the Israeli Supreme Court Judge Barak further clarified this and said that Securities Law warrants "Disclosure, disclosure again and more disclosure".[6]

In listed equity, the stock market serves as an information agent between companies and investors and therefore it is within its remit and its responsibility to make sure all relevant information is provided to investors, including ESG disclosures.

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[6] Source: ע"א 218/96בנבו פורסם בע"מ דיסקונט השקעות חברת 'נ מ"בע ישקר, 21.08.1997

6. SHOULD ESG DISCLOSURE REQUIREMENTS BE IMPOSED ON ALL LISTED COMPANIES?

האם יש הצדקה לגילוי מכלל החברות הנסחרות בבורסה?

ESG disclosure should be mandatorily required from all listed companies.

7. WHAT ARE THE COSTS AND RESOURCES ENTAILED IN THE PREPARATION OF ESG DISCLOSURES?

מהן התשומות והעלויות שעשויות להיות כרוכות בהכנת גילוי בנושאי **ESG** ?

Required costs and resources for ESG disclosure may vary between different companies depending on their starting point (whether they have been monitoring and reporting ESG information), their size, type of business and impact on ESG issues. As this should be a mandatory requirement like annual financial reporting, ESG data and analysis reporting should become an integral part of corporate reporting management. The costs and resources should be incorporated to those required for standard financial reporting.

In Israel there are over 256 Companies reporting voluntarily on ESG through various frameworks.[7] This shows that resources are already invested in ESG reporting and that companies have been developing expertise in ESG reporting. For companies already reporting through various voluntary frameworks or reporting directly to specific investors, a standardised ESG disclosure framework may save time and reduce costs and resources required for disclosure.

8. DO ESG DISCLOSURES POTENTIALLY CAUSE DAMAGE TO THE LISTED COMPANIES AND THE ISRAELI ECONOMY?

האם גילוי **ESG** עלול לגרום נזק לפעילותן העסקית של החברות הנסחרות בבורסה ולכלכלת ישראל?

The Israeli economy has suffered from a decline in foreign investments after MSCI has changed its index classification from MSCI emerging markets to MSCI world. This decline in passive investments means more focus is now set on attracting active foreign investors and sustaining their requirements.

More than 3000 investors worldwide have signed up to the PRI, incorporating ESG issues in their portfolio assessments. Increasing policy requirements around the world are requiring investors to incorporate ESG issues in investment decision making and disclose how they do so. Across the world's 50 largest economies, there are over 730 hard and soft-law policy revisions, across some 500 policy instruments, that support, encourage or require investors to consider long-term value drivers, including ESG issues.

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[7] 153 to Maala, 65 to GRI, 18 companies reporting to the Global Compact and 20 Companies have published independent corporate responsibility reports in 2019.
http://www.maala.org.il/%D7%93%D7%99%D7%A8%D7%95%D7%92-%D7%9E%D7%A2%D7%9C%D7%94/%d7%93%d7%99%d7%a8%d7%95%d7%92-%d7%9e%d7%a2%d7%9c%d7%94-2020/
https://database.globalreporting.org/search/
https://www.unglobalcompact.org/what-is-gc/participants/search?utf8=%E2%9C%93&search%5Bkeywords%5D=&search%5Bcountries%5D%5B%5D=85&search%5Bper_page%5D=10&search%5Bsort_field%5D=&search%5Bsort_direction%5D=asc
https://infospot.co.il/dp/%D7%93%D7%95%D7%97%D7%95%D7%AA_%D7%90%D7%97%D7%A8%D7%99%D7%95%D7%AA_%D7%AA%D7%90%D7%92%D7%99%D7%93%D7%99%D7%AA_2019

A standardised ESG disclosure framework will bring listed Israeli companies to the same line as listed companies internationally, providing material, comparable information to international investors. Mandating ESG disclosure may add value to Israeli companies in the long term.

Furthermore, ESG disclosure included in annual reports and overseen by the company board is likely to incentivise improvement on ESG performance and to lead to better governance and better management of ESG-related risks and opportunities. This can improve overall performance, create market efficiencies, and avoid unaccounted-for externalities. Improved ESG disclosure can also lead to increased investment in sustainable and green assets and create a positive impact on the Israeli economy.

9. IS THE PRESENT TIME, AGAINST THE BACKGROUND OF COVID-19 PANDEMIC, APPROPRIATE FOR ADDRESSING THIS ISSUE?

האם העיתוי הנוכחי, ברקע משבר נגיף הקורונה הנו עיתוי מתאים לטיפול בנושא?

Sustainable finance policy is receiving additional attention as governments and policymakers discuss how to rebuild their economies in the wake of the COVID-19 pandemic. There is a growing consensus that economic recovery strategies must be sustainable and inclusive and deliver concrete reforms that enable a more just and fair society. Specifically, policy makers need to seize the opportunities created by shifts in markets and behaviour to accelerate change, focusing on areas in which the COVID-19 recovery and decarbonisation priorities are best aligned. In order to create a decisive sustainable and inclusive transition, targeted government stimulus spending must be backed up by accelerated measures to build markets and policy frameworks that can deliver for people and the planet.

This is an opportunity to participate in the rebuilding of a sustainable financial system and to position Israel and Israeli companies at the forefront in this field. The present consultation by the ISA is a timely review of the financial system in Israel, better preparing it for the challenges ahead.

10. DO CURRENT DISCLOSURE REQUIREMENTS LIMIT MUTUAL FUNDS WITH ESG-ORIENTED INVESTMENT POLICIES FROM MAKING INVESTMENTS IN THE LOCAL STOCK EXCHANGE?

האם הגילוי שיש כיום מהווה מגבלה עבור קרנות נאמנות מוטות השקעות לפי קריטריונים של **ESG** מביצוע השקעות בבורסה המקומית?

Beyond mutual funds with ESG-oriented investment policies, all investors require standardised ESG information. The fiduciary duties of investors require them to incorporate ESG issues into investment analysis and decision-making processes, consistent with their investment time horizons. Along all material value drivers, ESG issues affect corporate performance, and should be incorporated in investment decision making.

Investors that fail to incorporate ESG issues are failing their fiduciary duties and are increasingly likely to be subject to legal challenge. Therefore, having inadequate disclosure standards will eventually prevent investors from making informed investment decisions in the local stock exchange.

11. IS IT NECESSARY TO INCENTIVISE LISTED COMPANIES TO INCLUDE ESG DISCLOSURES BY OFFERING TAX INCENTIVES AND/OR SUBSIDIZING THE COSTS OF ESG RATING REPORTS

האם יש מקום לתת תמריצים שונים, לרבות, תמריצי מס ו\או סבסוד הכנת דוחות דירוג בתחום לחברות נסחרות בבורסה אשר יכללו גילוי בנושאי **ESG** ?

Seeing that ESG disclosure is an integral part of annual financial reporting, companies should be required to disclose rather than be encouraged by any type of incentive. If the ISA wishes to support companies in building their ESG disclosure capacity it may offer educational resources and training for companies who have not yet developed ESG reporting capabilities.

This response has been prepared by Michal Fonea Alexandron, Senior Consultant.

The PRI has experience of public policy on ESG disclosure and responsible investment across multiple markets and is available to further support the work of the ISA on promoting ESG disclosure and sustainable investment.

Any question or comments can be sent to policy@unpri.org.