PRI Principles for Responsible Investment

PRI STATEMENT ON CLARIFICATION OF FIDUCIARY DUTIES AND CONSIDERATION OF SUSTAINABILITY PREFERENCES IN THE EU

30 April 2021

The European Commission has published six amending delegated acts[1] on fiduciary duties, investment and insurance advice, as part of a comprehensive package of sustainable finance measures[2]. These delegated acts (DAs) require financial firms, such as advisers, asset managers and insurers, to include sustainability factors in their procedures and to consider the sustainability preferences of their clients. PRI welcomes these amendments, which will support investors to make informed investment decisions aligned with global sustainability objectives, as part of their fiduciary duties.

FIDUCIARY DUTIES

The PRI supports the action taken by the European Commission to clarify current fiduciary duty rules for asset managers, insurance undertakings, and other investors and their relation to the assessment of sustainability risks. This clarification, although already accounted for by many investors in their interpretation of fiduciary duties, is a crucial step forward to steer entire capital markets towards improved sustainability practices.

As the world's leading proponent of responsible investment, the PRI advocates for global sustainable financial systems, supported by clear and robust investors' duties to incorporate ESG-related considerations in their investment decision making[3]. Outdated perceptions of fiduciary duty and sustainability, and regulatory ambiguity have contributed to the lack of systematic integration of sustainability factors by investors. This was emphasised in the market responses to the 2016 consultation on long-term sustainable investment[4] and the 2017 consultation on the Capital Markets Union mid-term review[5], as well as the recommendations of the High-Level Expert Group on Sustainable Finance (HLEG)[6].

The modern interpretation of fiduciary duty

In 2019, PRI published the Fiduciary duty in the 21st century final report, which clarifies investor obligations and duties in relation to the integration of ESG issues in investment practice and decision making. The PRI considers, in line with HLEG recommendations, that to reorient financial systems towards long-term sustainability, fiduciary duties of investors should require them to:

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[1] These amending delegated acts involve amendments to: Directive 2010/43 (relating to UCITS); Delegated Regulation (EU) No 231/2013 (relating to AIFM); Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359 (relating to IDD); Delegated Regulation (EU) 2015/35 (relating to Solvency II); Delegated Regulation (EU) 2017/565 (relating to MiFID II); and Delegated Regulation (EU) 2017/593 (relating to MiFID II).

[2] The European Commission's sustainable finance package aims to help improve the flow of money towards sustainable activities across the European Union. It contains 3 measures: the EU Taxonomy Climate Delegated Act, a proposal for a Corporate Sustainability Reporting Directive, and six amending Delegated Acts on sustainability preferences, fiduciary duties and product governance.

[3] PRI's and the World Bank's policy toolkit: How policy makers can implement reforms for a sustainable financial system | Reports/Guides | PRI (unpri.org)

[4] https://ec.europa.eu/information_society/newsroom/image/document/2016-44/feedback_final_pc_30068_en_19173.pdf

[5] https://ec.europa.eu/info/publications/mid-term-review-capital-markets-union-action-plan_en

[6] https://ec.europa.eu/info/sites/default/files/170713-sustainable-finance-report_en.pdf

- Incorporate ESG issues into investment analysis and decision-making processes, consistent with their investment time horizons.
- Encourage high standards of ESG performance in the companies or other entities in which they invest.
- Understand and incorporate beneficiaries' and savers' sustainability-related preferences, regardless of whether these preferences are financially material.
- Support the stability and resilience of the financial system.
- Report on how they have implemented these commitments.

Incorporating ESG issues: looking at both risk and impact

Thorough assessment of sustainability risks, and ensuring this is an explicit part of investor duties, is essential. However, it is not sufficient to guarantee that capital markets will align with sustainability goals. Analysis of ESG factors must also involve an assessment of how investments affect ESG issues, i.e. the sustainability impact[7] of investment decisions in the real world.

Considerable voluntary investor action, such as the UN-convened Net Zero Asset Owners Alliance and the Net Zero Asset Managers Initiative, demonstrate that investors do already take firm action on impact and align with the Paris Agreement. However, expectations to minimise harms and substantially contribute to environmental and social goals through capital allocation are ever increasing, and therefore **the Commission should provide further clarity for investors on the use of their investment powers with respect to sustainability impact.**

The PRI, together with the UN Environment Programme Finance Initiative and the Generation Foundation, have commissioned legal analysis to determine the extent to which investor duties currently enable investors to incorporate sustainability impact in their investment decision-making. This project, Legal Framework for Impact, will provide recommendations for policy change to remove any legal impediments to accounting for sustainability impact as a core part of investment. The final recommendations will be published later this year. Building a bridge between financial risk and real-world outcomes is the central aim of PRI's upcoming 2021-2024 strategy.

Analysis of final DAs

Within the final DAs underpinning UCITS, AIFM and MiFID II we welcome the amendments which state that sustainability risks should be considered in risk management, conflict of interest and governance. While the amendments do not directly address the rules regarding acting in the best interest of clients, the European Supervisory Authorities (ESAs) concluded that these amendments were technically equivalent and would achieve the same outcome and were therefore were sufficient to ensure systematic incorporation of ESG risks.

With regards to impact, the final amendments, while positive, are not comprehensive. For example, for those relating to UCITS and AIFM, the financial market participant must consider principal adverse impacts as well as sustainability risks as part of their due diligence, but only if they already do this under the SFDR, and only for due diligence assessments. In the case of DA related to Solvency II, the PRI supports the requirement to take into account sustainability impacts when assessing risks under the prudent person principle; this will better support insurers and reinsurers seeking to integrate impact considerations. However, practical challenges may remain in the absence of clear guidance on resolving potential conflicts between sustainability impact and financial return as part of investors fiduciary duty.

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[7] PRI defines impact as a change in outcomes – see "sustainability outcomes" Reporting Framework glossary | Articles | PRI (unpri.org)

SUSTAINABILITY PREFERENCES

Responding to the sustainability preferences of clients is an important driver of sustainability impact management. The PRI strongly supports the Commission's work to require dialogue between financial institutions and their institutional and retail clients around the sustainability preferences clients may hold. This systematic inclusion of sustainability preferences will play a significant role in reorienting financial flows towards sustainable activities; investors will be better empowered as demand for sustainability-focussed financial instruments and products increases.

Analysis of the final DAs

We welcome the amendments the Commission has made to the definition of sustainability preferences in the DAs underpinning Solvency II, IDD and one of those for MiFID II, as compared to their proposal last June. As stated in our consultation response, there were many disadvantages to basing sustainability preferences on fund types. This final proposal is an improvement because, when expressing their sustainability preferences, it allows clients to:

- Request a certain Taxonomy alignment, which may drive demand for Taxonomy-aligned products;
- Select a product with a minimum proportion invested in sustainable investments (as defined under the SFDR);
- Choose products that consider certain principal adverse impacts on sustainability factors; and/or
- Express no preferences and instead rely on (rapidly improving) EU regulatory minimum standards for all investment products, if they so wish.

This increased flexibility and clarity around the choices clients have to increase their positive impact and avoid adverse impacts will be helpful in creating meaningful dialogue with financial advisors. It also allows investors to be active owners for the percentage of their products which aren't defined as sustainable investments; in many cases, exposure to harmful activities is essential to influencing environmental performance of underlying investee (for example, through voting in support of adoption of meaningful climate transition plans).

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