February 25, 2021

Chairman Brad Sherman
Ranking Member Bill Huizenga
Members of the Subcommittee
U.S. House Committee on Financial Services
Subcommittee on Investor Protection, Entrepreneurship and Capital Markets
2129 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Sherman, Ranking Member Huizenga and Members of the Subcommittee,

The Principles for Responsible Investment (PRI) welcomes the opportunity to submit this statement for the record for the Subcommittee on Investor Protection, Entrepreneurship and Capital Markets’ hearing entitled, “Climate Change and Social Responsibility: Helping Corporate Boards and Investors Make Decisions for a Sustainable World.”

The PRI is the world’s leading initiative on responsible investment. We work to understand the investment implications of environmental, social and governance (ESG) factors and to support our international network of investor signatories in incorporating these factors into their investment and ownership decisions. Launched in New York in 2006, the PRI has grown to over 3,500 signatories (pension funds, insurers, investment managers, and service providers) globally with approximately $10 trillion in assets under management.1 The U.S. is the PRI’s largest market, with more than 700 signatories.2

The PRI commends the Subcommittee for calling this hearing and continuing efforts to consider legislative approaches to help corporate boards and investors support a sustainable world. With investors increasingly working to account for the climate and other ESG-related risks in their portfolios, it is increasingly important to support investor engagement with corporate leadership and ensure they have access to decision-useful information on business activities. Importantly, investors need access to consistent, comparable and standardized disclosure of material ESG data to make informed investment decisions, reduce portfolio risk and meet ESG goals. The bills under consideration at today’s hearing take important steps to address investors’ needs in this area.

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1 As of February 8, 2021.
2 An overview of the PRI’s signatories is available on the PRI website, https://www.unpri.org/signatories/signatory-resources/signatory-directory.
Eighteen months ago, the Subcommittee held a similar hearing and PRI provided our perspective that ESG factors are material and necessary considerations for investment decisions. Since then, investors have moved forward incorporating ESG considerations in their portfolios. PRI’s signatory base has grown in both number and assets under management, and top asset managers, such as BlackRock are calling on companies to take further action on climate change or lose out on funding.3

Now is the time for us to move policy that will support sustainable finance. Coordinated action at the national level is necessary to prevent the worst impacts of climate change, including shocks to our economy and society from an abrupt transition to a sustainable economy.4 Much of the rest of the global financial system has firmly established the materiality of ESG factors and moved in recent years to begin systematically integrating ESG in investment decisions. Every day we fail to act increases the risk to every Americans’ retirement savings and our broader financial system.

We commend the members of the Subcommittee for taking action to help the U.S. catch up with the progress made in other advanced economies and look forward to working with you and the 117th Congress to make the U.S. a global leader in ESG integration and climate action.

ESG FACTORS ARE MATERIAL

When investors sign the Principles for Responsible Investment, they agree to a set of activities to incorporate ESG considerations into their investment practices. Investors’ large, and growing, participation in the PRI reflects the increasing acknowledgment around the world that corporate action around ESG disclosure is not just, and can no longer be used as, a marketing gimmick.

Adoption of responsible investing, which for example works to limit portfolio exposure to climate change or human rights violations, is a critical step as the world economy transitions away from exploitative, exclusionary and short-term market practices. A study by the Government Accountability Office showed that most investors incorporate ESG information to better understand the risks that could affect company performance.5 However, responsible investment cannot be successfully conducted using the information required in the standard Form 10-K annual disclosure today.

More data and information from company leadership on material ESG factors is required for investors to implement a comprehensive responsible investment strategy. Only with consistent, comparable disclosure of issuer activities and exposure to climate change, can investors actively mitigate risks and capitalize on opportunities, increasing the long-term value of their investments and supporting a sustainable economy.


4 More information on the PRI’s Inevitable Policy Response project is available at: https://www.unpri.org/sustainability-issues/climate-change/inevitable-policy-response.

In the initial months of the COVID-19 global pandemic, risk mitigation was on every investor’s agenda and ESG integration proved to be an effective crisis protection measure. Between January and May 2020, 88 percent of sustainable funds outperformed their non-sustainable counterparts. Financial analysis and management firm Morningstar reported 51 of their 57 sustainable indices outperformed market counterparts in the first quarter of the year, and MSCI reported 15 of their 17 did the same. Over the course of last year, ESG funds consistently and overwhelmingly outperformed similar, non-ESG funds. A recent meta-analysis by the NYU Stern Center for Sustainable Business confirms the finding that ESG integration in investment strategies helps provide downside protections during economic crises.

ESG outperformance is not a trend limited to the coronavirus pandemic. In 2019, ESG funds continued to outperform the market. According to a long-term analysis by Morningstar, “a sample 745 Europe-based sustainable funds shows that the majority of strategies have done better than non-ESG funds over one, three, five and 10 years.” Calvert Research and Management found that over a ten-year period, companies in the top fifty percent of ESG ratings outperformed the bottom half by 6.8 percent. A recent meta-analysis of over 1,000 research papers published between 2015-2020 confirms that companies preparing for a low-carbon future financially outperform those that are not.

The evidence for ESG materiality is clear: ESG considerations impact company bottom lines and companies accounting for ESG factors achieve better financial performance. Considering ESG factors in operations has a positive impact on companies, for example by increasing the ability to identify and act on social and environmental risks and opportunities, creating new and expanded products and services and by improving management and board oversight of performance on key ESG issues. Furthermore, research has shown that responding to ESG risks can reduce operating

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13 Financial Times, Majority of ESG funds outperform wider market over 10 years (June 2020), available at: https://www.ft.com/content/733be6ff-446e-4f8b-86b2-19e4f2da3824.
16 Mozaffar Khan et al., Corporate Sustainability: First Evidence on Materiality (Jan 2016), available at: https://doi.org/10.2308/acoa-51583.
costs by up to 60 percent, for example through reduced energy and water use. Additionally, companies that incorporate ESG considerations are more likely to attract and retain quality employees.

**MANDATING ESG DISCLOSURE**

Investors regularly report to the PRI that a lack of consistent and comparable ESG data is a substantial barrier to their responsible investment practice. They look to this data for risk management, integration in valuation models, screening criteria, active ownership and communications with clients and beneficiaries, among other activities. The SEC has authority to require that issuers disclose ESG information but has yet to do so. Instead, the previous administration took active steps to make it more difficult for investors to integrate ESG disclosure in investment decisions.

While the Biden-Harris Administration has indicated their understanding that ESG factors are material, including by calling for an immediate review of the DOL’s *Financial Factors in Selecting Plan Investments* rule, Congress can jumpstart progress on a national disclosure standard. Legislation proposed in the 116th Congress, including the *Climate Risk Disclosure Act of 2019* and the *ESG Disclosure Simplification Act of 2019*, would make significant progress on ESG disclosure and provide clarity on the materiality of ESG factors for investors, and PRI is encouraged to see both bills reintroduced in the 117th Congress.

These bills and the others being discussed by the Subcommittee today represent the start of an earnest conversation in the U.S. to establish mandatory corporate disclosure of ESG-relevant information. This information is critical for investors and the general public to better understand climate and other risks, but also actions and progress toward measurable outcomes.

**UNIFIED DISCLOSURES**

Private market actors in the U.S. and internationally have developed voluntary ESG disclosure frameworks, some of which are widely used by market participants. This practice, however, has led to inefficiencies as companies can utilize multiple, different disclosure frameworks. This leads to information that is often not consistent or comparable and, therefore, difficult to systematically integrate into investment processes. It is also expensive for companies who choose to devote the resources to the production and regular updating of multiple ESG reports under different disclosure frameworks.

The lack of high quality, relevant and comparable corporate ESG data remains one of the

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19 Ibid.
central challenges faced by investors seeking to integrate these risks into their processes and increase their contribution to ESG outcomes. Therefore, the PRI is working with its global network of signatories to advocate for meaningful and globally comparable company disclosure, to promote the inclusion of material ESG information alongside other financial data and to encourage consolidation and harmonisation of reporting standards and regimes.

The PRI encourages the U.S. to consider ongoing global alignment efforts in any future disclosure requirements.

MODERNIZING FIDUCIARY DUTY

As earnest legislative and regulatory efforts are made to create disclosure requirements for ESG factors, investment advisors and asset managers serving as fiduciaries require clarity on their role in considering corporate ESG information in investment decisions. The previous administration added confusion to fiduciary duties, for example, with the Department of Labor’s Financial Factors in Selecting Plan Investments rule which requires fiduciaries to consider "pecuniary" investment factors without clearly establishing that ESG factors can, and often do, fall within that scope. While the final rule removed specific references to "ESG", the language surrounding the rule specifically targeted ESG considerations as beyond the scope of fiduciary duty or even in violation of that duty. The rule’s apparent aims relied on an outdated understanding of fiduciary duty and added uncertainty for fiduciaries as they seek to meet their obligations to clients regarding ESG factors.

In a 2019 survey, 90% of PRI signatories reported that consideration of ESG issues in their investment processes is a component of their fiduciary duties. The global financial community is aligned to increasingly incorporate these considerations in investment decisions even as an outdated regulatory regime continues to hinder full integration of ESG issues in the U.S.

The PRI continues to call on the SEC and DOL to modernize the duties of fiduciaries for a world in which the materiality of environmental, social and governance issues is well established. Congress also has an important role to play in this conversation, and the ability to end the regulatory confusion that has slowed incorporation of ESG factors and led to a riskier, less productive financial sector.

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On behalf of the PRI, I commend the Subcommittee for calling this hearing to consider how ESG factors are material to business operations and investment decisions. Today’s hearing represents an inflection point for U.S. policymaking toward advancing responsible investing in the largest financial market in the world. The PRI welcomes the opportunity to work with the Subcommittee to continue improving the bills considered today as the legislative process moves forward.

For further conversation and follow up, please contact our Washington, DC based team:

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- Greg Hershman, Senior Specialist, U.S. Policy: gregory.hershman@unpri.org

Yours sincerely,

Fiona Reynolds
Chief Executive Officer
Principles for Responsible Investment
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<th>Paper Title</th>
<th>Summary</th>
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<tr>
<td><strong>Financial performance of ESG integration in US investing</strong>&lt;sup&gt;23&lt;/sup&gt;</td>
<td>A 2018 PRI study that used ESG data provided by MSCI ESG Research to test a momentum strategy (improving ESG scores) and tilt strategy (high absolute ESG scores) across the world. The study concluded that ESG information offers investment outperformance advantages relative to respective benchmarks across all regions. For example, it concluded that, in the world portfolio, the ESG momentum and tilt strategies outperformed the MSCI World Index by 16.8% and 11.2% in active cumulative returns respectively over a ten-year period. These general findings are confirmed by two other studies.</td>
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<td><strong>Guidance and Case Studies for ESG Integration: Equities and Fixed Income</strong>&lt;sup&gt;24&lt;/sup&gt;</td>
<td>The CFA Institute and the Principles for Responsible Investment have produced a series of reports (for the Americas, Asia Pacific, and Europe, the Middle East and Africa) comprising guidance and case studies on how investors can analyse and integrate ESG issues into their investment research and decision-making processes.</td>
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<td><strong>ESG Investing Research Report</strong>&lt;sup&gt;25&lt;/sup&gt;</td>
<td>BoFA Merrill Lynch Global Research released information concluding that the stocks in its US portfolio that ranked within the top third by ESG scores (using ESG research from Thomson Reuters) outperformed stocks in the bottom third by 18 percentage points in the 2005 to 2015 period.</td>
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<td><strong>Corporate Sustainability: First Evidence on Materiality</strong>&lt;sup&gt;26&lt;/sup&gt;</td>
<td>This paper found that firms with good ratings on material sustainability issues significantly outperformed those with poor ratings on these issues. They also found that firms with high ratings on immaterial sustainability issues did not significantly outperform firms with low ratings on the same issues.</td>
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<sup>23</sup> Nguyen-Taylor, K. and Martindale, M., *Financial Performance of ESG Integration in US Investing* (Principles for Responsible Investment, London) (2018), available at: [https://www.unpri.org/download?ac=4218](https://www.unpri.org/download?ac=4218). A 2017 CFA Institute survey on ESG integration was used as a backdrop for this paper. The survey concluded that a proven link between ESG factors and financial performance would be among the top motivating reasons for those US investors that have not yet adopted ESG integration in their investment practices to do so.


<sup>25</sup> Subramanian et al., *ESG Part II: A Deeper Dive* (BoFA Merrill Lynch Global Research) (2019), available at: [https://about.bankofamerica.com/assets/pdf/2017_ESG-Update_online_ADA.pdf](https://about.bankofamerica.com/assets/pdf/2017_ESG-Update_online_ADA.pdf).

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<th>The ESG Advantage in Fixed Income Investing: An Empirical Analysis (Calvert Investments)(^{27})</th>
<th>This study concluded that companies ranked in the top half compared to bottom half of entities by aggregate ESG scores and by individual environmental, social and governance scores (using data from Reuters) delivered significant outperformance as measured by the annual rate of change in CDS spreads. These results appear to statistically validate the value proposition of investing in the credit of companies with superior ESG profiles.</th>
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<td>ESG and Financial Performance: Aggregated Evidence from more than 2000 Empirical Studies(^{28})</td>
<td>This study provides a more comprehensive analysis of investment performance in practice, as it analysed more than 2,000 empirical studies on the relationship between ESG criteria and investment performance dating back to the 1970s. The paper concluded that there is a well-established empirical evidence base to support the business case for analysing ESG in investment research and decision making. It notes that approximately 90% of studies find a nonnegative relationship between ESG performance and corporate financial performance, with the large majority of studies reporting positive findings.</td>
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<td>The Impact of Corporate Sustainability on Organizational Processes and Performance(^{29})</td>
<td>Using a matched sample of 180 US companies, the paper found that corporations that had voluntarily adopted sustainability policies significantly outperformed those that had adopted almost none of these policies, and that these ‘high sustainability’ firms generated significantly higher stock returns, signifying that indeed the integration of such issues into a company’s business model and strategy may be a source of competitive advantage in the long run.</td>
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<td>Corporate Social Responsibility and Access to Finance(^{30})</td>
<td>This paper found firms with better corporate social responsibility (CSR) performance, better stakeholder engagement and better transparency on ESG issues faced significantly lower capital constraints.</td>
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Additional academic research from the PRI, available at: [https://www.unpri.org/academic-research/academic-esg-review/5024.article](https://www.unpri.org/academic-research/academic-esg-review/5024.article).


