Principles for Responsible Investment

PRI RESPONSE

CONSULTATION WITH NON SUSTAINABLE FINANCE WORKING GROUP-MEMBERS TO SUPPORT THE 2023 SFWG RECOMMENDATIONS DEVELOPMENT.

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UN environment programme finance initiative
United Nations Global Compact
An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

ABOUT THE PRI

The Principles for Responsible Investment (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 range 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.

The PRI develops policy analysis and recommendations based on signatory views and evidence-based policy research. The PRI welcomes the opportunity to respond to the G20 Sustainable Finance Working Group (SFWG) consultation to support the 2023 SFWG recommendation developments.

ABOUT THIS CONSULTATION

The SFWG is developing recommendations to scale up social impact investment instruments, considering country-specific needs and circumstances. For this reason, it is requesting information from non-SFWG members.

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KEY RECOMMENDATIONS

The PRI welcomes the commitment of the G20 Sustainable Finance Working Group (SFWG) to develop a framework for scaling-up the adoption of social impact investment instruments. To this end, the SFWG should:

- Encourage G20 governments to adopt a whole-of-government approach to the economic transition that ties together real economy policies and financial policies, embedding sustainability outcomes.
- Encourage G20 policymakers to accelerate reforms to shift the baseline and clarify and adapt financial regulations to build a sustainable financial system. Areas of focus for social impact investment should include:
    - Corporate disclosures on social issues aligned with international human rights standards, and with the upcoming IFRS Sustainability Disclosure Standards.
    - Sustainable finance taxonomies including dedicated social taxonomies, or taxonomies including social issues.
    - Mandatory human rights and environmental due diligence regulations.
- Support a suite of mutually reinforcing Multilateral Development Banks (MDBs) reforms aimed at aligning public and private finance with wider sustainability goals. These include:
    - Review and revise organisational mandate, operating models, and expected outcomes to align with current global challenges.
    - Enhance catalytic financial instruments for global sustainability outcomes through reforming capital adequacy frameworks, exploring new financial structures.
    - Scale and aggregate concessional finance to increase financial efficiency and leverage greater lending.
    - Prioritise the mobilisation and alignment of private finance at scale with strong incentives, risk sharing, and mission clarity.
- Ensure that social issues and the dignity of people are placed at the centre of the economic transition. To this end, G20 governments should include a just transition in long-term climate transition strategies and in roadmaps for green and sustainable finance.

DETAILED RESPONSE

- ***What measures could governments and IOs consider to promote the development of robust pipelines of investment-ready social impact-focused projects?***

A whole-of-government approach to the economic transition that ties together real economy policies and financial policies is essential to shift financial flows and address key societal concerns such as climate change, rising inequalities, and key governance topics, such as responsible political engagement and anti-corruption.

In addition to the work of the Sustainable Finance Working Group, the G20 should commission detailed policy recommendations and implementation guidance on sustainable finance and real economy policies to multilateral organisations, such as the OECD and the IMF.

Through a whole-of-government approach, multilateral organisations involved in financial policy should provide detailed recommendations on policies and levers to align economies with net zero carbon emissions in a way that ensures the stability of social and environmental systems. This work should aim to break existing silos between financial and real economy policies and propose concrete actions for key sectoral policy reforms, and could include, for example, an action plan for Paris-aligned infrastructure investment.

G20 policymakers should accelerate reforms to shift the baseline and clarify and adapt financial regulations to build a sustainable financial system.

Financial policy reforms should be hardwired into existing finance and investment regulatory frameworks – sustainable finance should not be treated as separate, or optional, to mainstream finance. Investors can support sustainable economic growth and should be encouraged to do so. Legal analysis shows that investors can pursue sustainability impact goals that contribute to the sustainability of social systems while seeking financial returns.1

A whole-of-government approach to coherent sustainable finance policy reform includes, among others:

- **Corporate ESG disclosures**, including how sustainability data needs should be reflected in corporate reporting standards and regulatory reforms.[2] A PRI recent paper explored what data investors need to manage human rights risks[3] finding that, more and more, investors are considering not only the impacts on people that arise or could arise from their business activities and investee companies. Investors are also trying to understand how risks to people can create financial and reputational risk. To conduct this analysis, investors need different types of data throughout the investment process. But there are gaps in terms of available information and reliable sources – and where this information is available, it can be difficult to

[1] PRI, UNEP FI and the Generation Foundation (2021) 'A legal framework for impact'.

[2] PRI, Driving Meaningful Data, available at: https://www.unpri.org/sustainability-issues/driving-meaningful-data.

[3] PRI (2022), 'What data do investors need to manage human rights risks?'

access and process at scale. For this reason, governments should promote aligning corporate disclosures on social issues with international human rights standards. This will improve the consistency of information demanded of investee companies and the ability of investors and other stakeholders to develop insights about the human rights risks and impacts associated with their operations and value chains.

- **Stewardship**, or the use of influence by institutional investors to maximise the overall long-term value on which returns, and clients' and beneficiaries' interests, depend.
- **Investors' duties to incorporate ESG**-related considerations in their investment decision making, to provide sustainability-related disclosures and to report on their ESG incorporation policies and sustainability performance targets.
- **Taxonomies of sustainable economic activities**, defining common and clear criteria to classify projects or investments as green or sustainable. These should include dedicated social taxonomies – such as the proposed EU Social Taxonomy[4] – or taxonomies including social issues, such as the one recently adopted by Mexico.[5] When not covering specific social topics, Taxonomies should include the principles of Do No Significant Harm and/or Minimum Safeguards, so that Taxonomies do not promote activities that are contrary to other government policies and international agreements.
- **National/regional sustainable finance strategies**, that encourage and enable the low-carbon transition and the delivery of the SDGs for the whole economy.
- **Human rights and environmental due diligence regulations**. Due diligence regulations are a growing tool used by policymakers to ensure the alignment of investor and corporate activities with international goals. Robust due diligence requirements would:
    - support coherency and comparability between jurisdictions, in light of those in force or under development in several G20 jurisdictions;
    - support investors to discharge their responsibility to respect human rights under the UNGP and OECD Guidelines; and
    - protect investors from reputational risks and help them achieve higher risk-adjusted returns.

  Due diligence provisions should include a requirement on entities to continuously identify, prevent, and mitigate negative human rights impacts, and to remedy any harms they have caused or contributed to, where there is a clear link between their actions and the harm.

- ***What efforts could governments and IOs promote to improve the comparability, interoperability, and credibility of industry frameworks for the measurement and reporting of social impact?***

As highlighted in the PRI data paper, governments should promote aligning corporate disclosures on social issues with international human rights standards. This will improve the consistency of

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[4] Platform on Sustainable Finance (2022) 'Final report on social taxonomy'.

[5] Gobierno de Mexico (2023) 'Taxonomía Sostenible de México'.

information demanded of investee companies and the ability of investors and other stakeholders to develop insights about the human rights risks and impacts associated with their operations and value chains. It will set a common foundation for understanding how companies identify, assess, and manage those risks and impacts.

Policy reforms in this area should be designed in alignment with international standards such as the IFRS Sustainability Disclosure Standards (ISSB standards). They should be built in collaboration with international platforms such as the International Platform on Sustainable Finance (IPSF).

- ***How to better leverage MDBs to finance sustainability-aligned projects that are tailored to the needs of countries? How else could MDBs support more private sector sustainability-aligned investment? Please suggest specific policy recommendations or actions.***

The 21st century polycrisis – climate and biodiversity crises, international armed conflict, macroeconomic imbalances, growing inequality, public health risks, etc – are challenging governments and institutions to develop ambitious, globally coordinated responses. The multilateral financial architecture sits at the heart of meaningful responses to these crises.

Reforms are needed across the multilateral financial system to enable institutions to play a bigger, and more effective role in helping the world face today's challenges. Overall, achieving the transition to a sustainable and equitable economy that supports natural and social systems is not possible without meeting the financing needs of EMDEs. The investments required to achieve the economic transition in EMDEs also represent a tremendous opportunity for private finance. Investors are increasingly committing to and implementing their net zero goals in a way that is aligned with international social and human rights standards. However, private finance mobilisation to date is far too little, and requires systemic changes to public-private partnerships to systemically unlock them.

To this end, a suite of mutually reinforcing reforms is needed to align public and private finance with wider sustainability goals. Key recommendations include:

- **Review and revise organisational mandate, operating models, and expected outcomes to align with current global challenges.** MDBs need to evolve to tackle the polycrisis of today and deliver outcomes at the local and national level. This entails promoting sustainable economic growth, social equity, and tackling the planetary crisis of climate change and biodiversity loss as interconnected crises. Revising existing mandates to encompass today's crises will cascade down to the banks' operations, governance, and financing mechanisms.
- **Enhance catalytic financial instruments for global sustainability outcomes through reforming capital adequacy frameworks, exploring new financial structures.** There is great propensity for the MDBs to expand their combined lending and financing efficiency while maintaining current institutional ratings. Doing so requires the Banks to reform their approach to defining risks and evolve into first-risk takers with catalytic capital.
- **Scale and aggregate concessional finance to increase financial efficiency and leverage greater lending.** To bridge the gap between high investment risk in EMDEs and investors' fiduciary obligations to earn a risk-adjusted return, governments, foundations, and other

donors should enhance sizable and flexible pools of concessional capital to de-risk investments so as to bring them within investors' risk limits.

- **Prioritise the mobilisation and alignment of private finance at scale with strong incentives, risk sharing, and mission clarity.** Catalysing a much larger volume of private finance for investments towards sustainable outcomes remains the only viable avenue for achieving the financing scale and speed required, particularly in EMDEs. For responsible investors, allocating capital with positive real-world outcomes is key for reducing global risks to crises and for capturing sustainable returns.

  While ultimately, more capital injection or concessional contribution is a viable option to expand the private windows of MDBs, what is needed first, however, is to reform the business and financial models of these private windows. Increasing the available amounts of concessional finance for blending would not lead to more viable transaction or greater leverage ratios as a result.

  Specifically, shareholders should support the following changes in MDBs in order to turn the "billions to trillions" action plan into a reality:

  - **Transform from an originate-and-hold model to an originate-and-transfer model** for transactions at later stage or with demonstrable profitability, while retaining the wider sustainability and impact focus.[6]
  - **Focus on critical gaps in capital markets and on developing relevant instruments, while establishing systemic collaboration between the public and private arms of MDBs.**
  - **Deploy more concessional finance for risk management**, including for MDBs to take on more risks, reduce risks, and bear the first-mover cost of making projects more bankable. Scaling the concessional finance available to MDB private finance arms is one way of incentivising this.
  - **Fulfil revised mandate by delivering on financial returns adjusted for impact**, including impact around social development, emissions reductions, and ecosystem resilience. This may mean accepting financial returns that are positive but below-market at the portfolio level.
  - **Increase data transparency on risk to avoid unnecessary cost on capital and incentivise risk sharing.** MDBs shareholders can advocate for the Global Emerging Markets Risk Database (GEMs) to be expanded to include more holistic historical loss and recovery data from MDBs, with responsible access to GEMs provided to relevant risk takers and credit rating agencies. Confidentiality should be ensured through data aggregation as needed. Doing so can address issues related to risk misconception, and further crowd-in private capital.

[6] Center for Global Development *What Multilateral Development Banks Can Do to Mobilize Private Capital At Scale* (November 23, 2021): https://www.cgdev.org/blog/what-multilateral-development-banks-can-do-mobilize-private-capital-scale

- **Scale up technical assistance at the local level.** MDBs can leverage their existing presence and expertise on market-specific challenges and provide technical assistance such as building governments' capacity on regulation, equitable taxation, or phasing out harmful subsidies. Doing so would help cultivate a sustainable financial ecosystem and strengthen the financial architecture from local levels to the global.

- *Is innovation needed in the development of social impact financial instruments that consider socio-economic contexts and national priorities and that help to ensure wider adoption of the instruments? If so, how can innovation be promoted?*

No response

- *How can various stakeholders collaborate for promoting sharing of data, innovative tools and techniques, creating awareness and promoting capacity building for enhancing Social Impact Investment, and monitoring progress of SDGs at organisation/stakeholder level?*

Investor initiatives such as the PRI's Advance or the recently launched Global Investor Commission on Mining 2030 allow investors to pool their resources and expertise to engage with companies on issues related to human rights, decent work, and the just transition. This increases their leverage and ensures that the impact of their stewardship activities is maximised.

With regards to data, multistakeholder initiatives can ensure the development of disclosure frameworks that serve the needs of a range of stakeholders, including investors, policymakers and civil society. These frameworks should align with key elements from the global reporting landscape, to encourage the interoperability and possible future integration of their findings with global standard setting on corporate sustainability disclosure, such as the European Sustainability Reporting Standards (ESRS), and the ISSB standards. To this end, the PRI is following the work initiatives aimed at creating disclosure frameworks to support standard setters in this area.

- *Should the G20 consider any other policy recommendations to solve the aforementioned challenges (see the 'context' section)? Please provide one or more recommendations and specify if they apply to MDBs, Ministries of Finance and Central Banks, IOs, policy makers, institutional investors, other private sector actors, etc.*

Policymakers, companies, and investors have a key role to play in ensuring that human rights and climate justice are upheld throughout the much-needed fast transition to a net-zero carbon economy. Governments need to include a just transition in long-term climate transition strategies and in roadmaps for green and sustainable finance. This includes:

- Collaborating on **just transition** plans with workers and communities reliant on the fossil fuel sector and other carbon intensive sectors and ensuring meaningful social dialogue with trade unions and workers as set out in the ILO Guidelines for a just transition.

- Integrating **human rights due diligence** throughout climate solutions from policy to project-level and throughout supply chains, as set out in the UN Guiding Principles on Business and Human Rights and the OECD Guidelines on Multinational Enterprises.

- Ensuring **equitable distribution of access to energy and climate solutions** at an affordable price and encouraging ownership and/or co-benefits of climate solutions by indigenous groups and disadvantaged communities.
- Ensuring rigorous rules for **public participation, social and environmental safeguards, and independent grievance mechanisms** for any climate solutions financed under Article 6 of the Paris Agreement.

The PRI has experience of contributing to public policy on sustainable finance and responsible investment across multiple markets and stands ready to support the work of the G20 Sustainable Finance Working Group further to promote the adoption of social impact investment instruments in developed and developing economies.

Please send any questions or comments to policy@unpri.org.

More information on www.unpri.org