CONSULTATION RESPONSE

EU: RENEWED SUSTAINABLE FINANCE STRATEGY

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THE PRINCIPLES FOR RESPONSIBLE INVESTMENT (PRI)

The 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 menu 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.

This consultation response represents the view of the PRI Association and not necessarily the views of its individual members.

More information: www.unpri.org

SOURCES

This response draws from a wide range of PRI publications and projects, including (but not limited to):

- 10 year Blueprint for Responsible Investment (2016)
- Stewardship 2.0 (November 2019)
- Challenges and solutions for ESG in passive investment (Survey, October 2019)
- Investor Priorities for the EU Green Deal (March 2020)
- Investing with SDG Outcomes (June 2020)
- Private Finance and the EU Green Recovery (Roundtable and survey, July 2020)
- Driving Meaningful Data (forthcoming, 2020)
- A Legal Framework for Impact (forthcoming, 2020)
- Investor Action on Biodiversity (forthcoming, 2020)
- ESG in Credit Risk and Ratings initiative (ongoing)

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SUMMARY OF PRI RESPONSE

The European Union has led the globe in sustainable finance reforms. But despite, this, capital markets remain unsustainable. The implications for European savers and citizens are profound.

The revised Sustainable Finance strategy is a generational opportunity - to put in place guidance, tools and regulation; to remove barriers; to realign Europe's capital markets with sustainability objectives; and to work urgently with governments and investors beyond Europe's borders.

That this should be achieved is not inevitable. It requires concerted action from governments, policymakers, investors and companies.

To support the success of this strategy, the PRI makes the following overarching recommendations:

1. **The revised strategy should provide a clear, ambitious and compelling vision of the finance industry of the future**, aligned with the Paris Agreement and the Sustainable Development Goals. For example, a system where EU Citizens' long-term savings and investments are fully resilient to future sustainability shocks and can be aligned with their values, where institutional investors systematically track, measure and optimise the outcomes (positive and negative) from investment activity, and where a vibrant and flourishing market for sustainable products enables a race to the top between providers. Many of the building blocks for a sustainable financial system already exist, developed through the existing Action Plan on Sustainable Finance. What is missing is how they relate to the long-term vision for the sector, and to each other.

2. **It must build from a strong foundation.** In some cases, implementation of the existing Action Plan is falling short. The PRI has contributed extensively to initiatives such as the EU Taxonomy, the Disclosure Regulation and the Non-Financial Reporting Directive, but we are concerned that these initiatives are developing in isolation from each other and in places are not based on an adequate understanding of investment practice. Further sustainable finance measures should also be carefully prioritised. This consultation covers a huge array of potential topics, many of which are different approaches to the same fundamental questions around risk, impact and disclosure. Finally, the new strategy must also accurately reflect the tools investors have to create change. It must move away from the assumption that the impact of an investment strategy is the same as the characteristics of the underlying portfolio, and instead support and develop the full range of tools investors have available to influence real-economy outcomes, including capital allocation, stewardship and real-economy policy engagement.

3. **Sustainable finance must be central to a Green Recovery.** As Europe begins to emerge from the COVID-19 pandemic, investors have signalled deep support for Europe's Green Recovery[1], and many are considering the role they can play. The proposed EUR 1.8 trillion

[1] For example: https://theinvestoragenda.org/wp-content/uploads/2020/06/Open-letter-to-EU-leaders-from-investors-on-a-sustainable-recovery-from-COVID-19.pdf

recovery package will shape Europe's economy in the coming decades. The Sustainable Finance Action Plan must also work alongside the green recovery and contribute to the Sustainable Development Goals. Central to this, we see the EU Taxonomy – expanded to include social issues - as a tool to enable investors, issuers, policymakers and other stakeholders to work together in pursuit of a sustainable and equitable European economy, true to the original vision of the High Level Expert Group on Sustainable Finance.

4. **The EU must work towards international ambition and greater harmonisation.** The EU's action will resonate around the world, and will set a standard for a global financial framework aligned with sustainability. As first mover, Europe will benefit – but must also work with other willing countries, and investors around the world, to develop international applications. Many investors operate across the globe, and many EU sustainable finance regulations, such as the EU Taxonomy or the SFRD, require investors to disclose information about the sustainability risks and impacts of their investments irrespective of where the investees are. There is a clear and urgent need for harmonisation of corporate and investor disclosure requirements and Taxonomies which can support the implementation of The Paris Agreement and the SDGs.

https://www.euractiv.com/section/energy-environment/news/financiers-join-eu-green-recovery-alliance/

Section I: Questions Addressed to all stakeholders on how the financial sector and the economy can become more sustainable

In some cases, the PRI has submitted an abridged version of the below responses to meet the character limits.

1. **With the increased ambition of the European Green Deal and the urgency with which we need to act to tackle the climate and environmental-related challenges, do you think that (please select one of the following)**

   - <u>Major additional policy actions are needed to accelerate the systematic sustainability transition of the EU financial sector.</u>
   - Incremental additional actions may be needed in targeted areas, but existing actions implemented under the Action Plan on Financing Sustainable Growth are largely sufficient.
   - No further policy action is needed for the time being.
   - Don't know / no opinion / not relevant

2. **Do you know with sufficient confidence if some of your pension, life insurance premium or any other personal savings are invested in sustainable financial assets?**

   - Yes
   - No
   - Do not know

[No PRI answer – question is directed to individuals/citizens]

2.1 If yes, do you consider that you have had sufficient access to information with regard to the integration of sustainability criteria and options to invest in sustainable financial assets? Please explain and specify whether you searched for the information yourself or whether the information was made available to you.

[No PRI answer – question is directed to individuals/citizens]

If no, would you like to be offered more information with regard to the integration of sustainability criteria and options to invest in sustainable financial assets and divest from non-sustainable assets?

- Yes
- No
- Do not know

[No PRI answer – question is directed to individuals/citizens]

2.2 If necessary, please explain your answer [BOX 2000 characters].

3. **When looking for investment opportunities, would you like to be systematically offered sustainable investment products as a default option by your financial adviser, provided the product suits your other needs?**

- Yes
- No
- Do not know

[No PRI answer – question is directed to individuals/citizens]

4. **Would you consider it useful if corporates and financial institutions were required to communicate if and explain how their business strategies and targets contribute to reaching the goals of the Paris Agreement?**

- Yes, corporates
- Yes, financial institutions
- <u>Yes, both</u>
- No
- Don't know / no opinion / not relevant

4.1 If no, what other steps should be taken instead to accelerate the adoption by corporates and financial sector firms of business targets, strategies and practices that aim to align their emissions and activities with the goals of the Paris Agreement? [BOX, 2000 characters]

5. **One of the objectives of the European Commission's 2018 Action Plan on Financing Sustainable Growth is to encourage investors to finance sustainable activities and projects. Do you believe the EU should also take further action to (1= Strongly Disagree, 5= Strongly Agree):**

Encourage investors to engage, including making use of their voting rights, with companies conducting environmentally harmful activities that are not in line with environmental objectives and the EU-wide trajectory for greenhouse gas emission reductions, as part of the European Climate Law, with a view to encouraging these companies to adopt more sustainable business models	5 – Strongly Agree
Discourage investors from financing environmentally harmful activities that are not in line with environmental objectives and the EU-	2 – Disagree

wide trajectory for greenhouse gas emission reductions, as part of the European Climate Law	

Question 5.1 - In case you agree or strongly agree with one or both options [4-5]: what should the EU do to reach this objective? [BOX, 2000 characters]

This answer relates to both stewardship (exercise of ownership rights) and discouraging investors from financing harmful activities.

The EU should take action to reduce environmentally harmful activities. However, we disagree with the characterisation of investment in this question. In many cases, institutional investors are not directly financing harmful activities. Listed equity investment, for example, involves investing in companies who may pursue harmful activities, often through buying shares on secondary markets. No money is exchanged between the investor and the company in this transaction. However, the investor does gain formal (and informal) ownership rights, such as the right to vote, raise shareholder resolutions and engage with management which can be used to challenge the company to improve strategy and investment planning in pursuit of better environmental performance.

Discouraging investors from investing in these companies, with no exceptions, would undermine the role of investors as long-term stewards and ultimately could undermine the low-carbon transition. The companies creating the most harm are those where the greatest improvements are needed.

The EU should discourage companies and other issuers, such as Member State and Municipal Governments, from pursuing environmentally harmful activities, such as those in conflict with the EU's 2030 and 2050 climate goals. The EU should support investors to use the most appropriate and powerful sources of leverage to encourage investees in the low-carbon transition, but this may vary depending on the asset class. (Further action may be warranted to address private, family or state-owned companies who may not rely on capital markets for financing at all).

The existing EU legislative framework could go further to incentivise high-quality, outcomes-focussed stewardship. Stewardship is one of the most powerful tools investors have to influence underlying investees and to drive real change in the global economy, environment and society, as well as being central to investors' fulfilling their fiduciary (or equivalent) duties. The EU should also ensure clarity and certainty on the low-carbon transition through the EU Climate Law to enable effective stewardship around shared objectives.

More detailed recommendations on stewardship are made in response to question 42.

Section II: Questions Targeted At Experts

6. **What do you see as the three main challenges and three main opportunities for mainstreaming sustainability in the financial sector over the coming 10 years? [BOX max. 2000 characters]**

Opportunities

i. **Europe's Green Recovery.** The proposed EUR 1.8 trillion Recovery Package will have a profound impact on Europe's economy in the coming years. It is an important signal to investors and other stakeholders about the pace and nature of Europe's transition, and the commitment of the EU and Member States to achieving climate neutrality and environmental and social sustainability. Investors have signalled strong support for a recovery aligned to the EU Green Deal.[2]

   The plan must connect Europe's investment needs to the most appropriate types of financing or other support. The Recovery Package has identified substantial investment needs on a sectoral basis. On a more granular level, this ranges from technologies that are already financed by the private sector on a wide scale (such as wind power), through to longer-term R&D projects targeting disruptive technologies which are not yet able to be financed by the private sector (such as carbon capture and storage). It also includes technologies where other forms of support, such as alignment of incentives, public procurement or standardisation (eg. pan-European harmonisation of EPC ratings for homes) would bring substantial benefits. A sophisticated review of capital needs and other support should be integrated into the design of EU and Member State recovery planning to maximise the opportunities for investors.

ii. **Stewardship.** Stewardship is a critical tool for investors seeking to manage ESG risks and improve outcomes in the real economy. In many situations, it is the most powerful form of leverage an investor has. To date, much EU action on sustainable finance has focussed on capital allocation at the expense of stewardship. Developing Europe's ambition on stewardship is a huge opportunity to harness the influence of the investment sector in support of shared goals like climate neutrality.

iii. **Establishing a framework for sustainability impact**. This is both an opportunity and a challenge. The EU has started to introduce impact concepts into investor disclosure requirements, but implementation weaknesses and conflicts in the legal framework around fiduciary duties remain which restrict investors' ability to systematically integrate sustainability impact considerations in their investment activity.

Challenges

[2] See *Open letter to EU leaders from investors on a sustainable recovery from COVID-19* https://theinvestoragenda.org/wp-content/uploads/2020/06/Open-letter-to-EU-leaders-from-investors-on-a-sustainable-recovery-from-COVID-19.pdf

i. **Data**. Investors consistently report to the PRI that a lack of consistent and comparable ESG data is a substantial barrier to their responsible investment practice. Rising awareness of the need to understand sustainability performance in the context of social and environmental outcomes means that new types of data will be required. In the immediate term, several investor disclosure obligations will be brought in before corresponding corporate data is available. The EU should offer clarification on the supervisory approach and expectations during this period.

ii. **International fragmentation.** Many investors operate across the globe, and many EU sustainable finance regulations, such as the EU Taxonomy or the SFRD, require investors to disclose information about the risks and impacts of their investments irrespective of where the investees are. There is a clear and urgent need for harmonisation of corporate and investor disclosure requirements and Taxonomies.

iii. **Impact.** As above, the existing legal framework restricts many investors' ability to consider the impact of their investments.

7. Overall, can you identify specific obstacles in current EU policies and regulations that hinder the development of sustainable finance and the integration and management of climate, environmental and social risks into financial decision-making?
Please provide a maximum of three examples [BOX max. 2000 characters]

i. The Non-Financial Reporting Directive, which we note is currently under revision, does not provide adequate disclosure from corporates. Some investors (particularly insurance companies) qualify as public interest entities under NFRD. The scope of their reporting (for example, whether it relates to their investment activities or own estate) is not implemented consistently in Member State frameworks, and there is the potential for misalignment between this set of obligations, SFDR obligations and forthcoming entity-level Taxonomy obligations for public interest entities.

ii. Fiduciary duties. See also our response to Q91.
   a. The Commission's proposed amendments to the delegated acts underpinning UCITS, MIFID II and AIFMD clarify that sustainability risks should be considered in risk management and governance. However, they do not directly clarify the need to integrate sustainability risks when acting in the best interests of investors/clients. In the absence of any further clarification on the relationship between sustainability impact and fiduciary duties, investors are likely to continue to resolve conflicts between sustainability and financial objectives in favour of financial objectives.
   b. IORP II permits, but does not compel, pension funds to consider sustainability impact.

iii. The proposed Regulatory Technical Standards supporting SFDR, currently under consultation. The PRI strongly supports the aims of the RTS, including harmonisation of impact disclosure obligations, but the current proposal would create a substantial reporting burden while actively misleading end investors as to the likely impact of the investment product or service they are procuring. This requires urgent reconsideration.

8. **The transition towards a climate neutral economy might have socioeconomic impacts, arising either from economic restructuring related to industrial decarbonisation, because of increased climate change-related effects, or a combination thereof. For instance, persons in vulnerable situations or at risk of social exclusion and in need of access to essential services including water, sanitation, energy or transport, may be particularly affected, as well as workers in sectors that are particularly affected by the decarbonisation agenda. How could the EU ensure that the financial tools developed to increase sustainable investment flows and manage climate and environmental risks have, to the extent possible, no or limited negative socio-economic impacts? [BOX, 2000 characters]**

The PRI is strongly supportive of the just transition to a low-carbon economy agenda. Investors representing $10 trillion of assets under management have signed onto the PRI Investor Statement of Commitment to Support a Just transition on Climate Change.

We note three types of challenges in terms of potential negative socioeconomic impacts:

1. the impacts on workers in sectors affected by decarbonisation;
2. the impacts on communities who heavily rely on sectors affected by decarbonisation, and communities in proximity to new renewable energy installations;
3. access to affordable energy, transport and other essential services.

These challenges should be integrated into scenario analysis undertaken by investors (for example, through responding to the recommendations of the Taskforce on Climate-Related Financial Disclosures), companies and the EU and Member States (such as the EU Long-term decarbonisation trajectory under the proposed Climate Law, the proposed Recovery plan and Resilience Facility and Solvency Support Instrument as well as the implementation of the Just Transition Mechanism).

Building the Just Transition into scenario planning by the EU and Member States will enable a clearer sense of the Member State, regional and local investment needs, and therefore assessment of the necessary types of financial or other support to ensure a just transition.

Practically speaking, plans and strategies for just transition should be based on the ILO's Guidelines for a Just Transition; consistent with the Paris Agreement's upper limit for global temperature increases of 1.5C or well below 2 C; and consistent with the goals of social protection, social inclusion and decent work for all. Rights, including labour, gender, indigenous and Treaty rights, should be part of the planning process and respected.

One opportunity would be to consider the Just Transition as a social objective, or embedded within the social objectives, of a future EU Social Taxonomy. This would support the widespread integration of Just Transition-aligned activities into investment processes and provide profile and visibility for project promoters and issuers seeking to finance Just Transition aligned projects.

9. **As a corporate or a financial institution, how important is it for you that policy-makers create a predictable and well-communicated policy framework that provides a clear EU-wide trajectory on greenhouse gas emission reductions, based on the climate objectives set out in the European Green Deal, including policy signals on the appropriate pace of phasing out certain assets that are likely to be stranded in the future?**

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral
- 4 - Rather important
- <u>5 - Very important</u>
- Don't know / no opinion / not relevant

Question 9.1 - What are, in your view, the mechanisms necessary to be put in place by policy-makers to best give the right signals to you as <u>a corporate or a financial institution</u>? [BOX, 2000 characters]

The EU is now entering a phase where implementation plans for major sectoral low-carbon transitions should be established. This should include analysis and securing of supply chain components, skills and workforce development, subsidy alignment, regulatory approval process alignment and private financing needs in order to ensure that necessary green markets can function in practice and delivery the sustainable economic transition that is required. Three critical opportunities are listed below.

i. **Europe's Green Recovery**. The proposed EUR 1.8 trillion Recovery Package is an important signal to investors and other stakeholders about the pace and nature of Europe's transition, and the commitment of the EU and Member States to achieving climate neutrality and environmental and social sustainability. Investors have welcomed the Commission's proposal to integrate sustainability into the recovery package, but clear, concrete and ambitious commitments must be made in the deployment of the specific recovery instruments at EU and Member State level. In particular, the Recovery and Resilience Fund, the Solvency Support Instrument, the Just Transition Mechanism, European Regional Development Funding and InvestEU (including the new Strategic Investment Facility). Concrete commitments to align these recovery plans with the EU Taxonomy would send a very strong signal that the EU and Member States are holding themselves to the same standard as investors, and increase potential synergies.

ii. **Climate Law**. The EU should ensure clarity and certainty on the low-carbon transition through the EU Climate Law. The EU Climate Law should be adopted as soon as feasible. While 2030 targets are welcome, ten years is outside the typical timeframe for business and investment decision-making. As such, we strongly recommend that the Climate Law include 5-yearly interim targets consistent with the 2030 and 2050 targets, starting from 2025. The EU-wide climate trajectory should also be established from 2025. In addition, the EU should follow international best practice and establish and independent scientific body to provide scrutiny of the EU-wide trajectory, progress reporting and the consistency of EU instruments with the climate trajectory. This should be separate to the European Commission and the Platform on Sustainable Finance.

iii. **National Energy and Climate Plans** (NECPs) should also be strengthened. NEPCs are required to state how fossil fuel subsidies will be phased out, but analysis of draft NECPs indicates that many either do not mention fossil fuel subsidies or put forward plans to continue subsidies with no clear date for phase-out.

10. **Should institutional investors and credit institutions be required to estimate and disclose which temperature scenario their portfolios are financing (e.g. 2°C, 3°C, 4°C), in comparison with the goals of the Paris Agreement, and on the basis of a common EU-wide methodology?**

- Yes, investors
- Yes, credit institutions
- Yes, both
- <u>No</u>
- Do not know

The options available do not reflect the PRI's view.

The EU has already introduced various disclosure obligations, at a firm and fund level, seeking to understand the impact of investment and the alignment of investment activity with long-term climate objectives. Implied warming should not be added on top of those obligations, but should be considered as one possible metric to enable investors to comply with the existing suite of disclosure requirements, for example, the proposed Regulatory Technical Standards supporting the sustainability disclosures regulation.

Implied warming is a valuable metric as it is connecting the achievement of The Paris Agreement to day to day investment decision-making and can help to establish the need for action. However, consideration should also be given to portfolio alignment with the EU Taxonomy, which also has a role in understanding and increasing the alignment of portfolios with the EU's climate neutrality commitments.

11. **Corporates, investors, and financial institutions are becoming increasingly aware of the correlation between biodiversity loss and climate change and the negative impacts of biodiversity loss in particular on corporates who are dependent on ecosystem services, such as in sectors like agriculture, extractives, fisheries, forestry and construction. The importance of biodiversity and ecosystem services is already acknowledged in the EU Taxonomy. However, in light of the growing negative impact of biodiversity loss on companies' profitability and long-term prospects, as well as its strong connection with climate change, do you think the EU's sustainable finance agenda should better reflect growing importance of biodiversity loss?**

<u>Yes</u>
No
Do not know

11.1 - If yes, please specify potential actions the EU could take. [BOX max. 2000 characters]

Biodiversity is already implicit within many of the existing and planned EU sustainable finance reforms, under the umbrella term of sustainability. As such, it is more a question of promoting the importance of, and opportunities for, biodiversity financing and supporting the development of harmonised methodologies and metrics.

In addition to delivering the technical screening criteria required to expand the EU Taxonomy to activities making a substantial contribution to protection and restoration of healthy ecosystems, the EU should ensure that the proposed non-financial reporting standard include high quality metrics of biodiversity dependence and impacts. This will also involve providing clarity on corporate reporting requirements and enhancing data accessibility and credibility.

Beyond actions targeting investors, protection and restoration of biodiversity must be integrated into Europe's proposed Recovery plan, Member State Recovery and Resilience plans and sector strategies. A more sophisticated and granular understanding of sectoral investment needs and the necessary forms of financing required would increase opportunities for private investors.

12. **In your opinion, how can the Commission best ensure that the sustainable finance agenda is appropriately governed over the long term at the EU level in order to cover the private and public funding side, measure financial flows towards sustainable investments and gauge the EU's progress towards its commitments under the European Green Deal and Green Deal Investment Plan? [BOX, 2000 characters]**

Debates around the sustainability of sectors including energy, agriculture and fishing, transport and industry have been underway for many years, with high levels of complexity. Connections are not always being made between sustainable finance and discussions underway in the real economy, and investors do not always feel they have the same influence and access as groups such as NGOs or business associations.

PRI research identified that investors felt the Technical Expert Group on Sustainable Finance provided a positive model and the forthcoming International Platform on Sustainable Finance should encourage greater inter-sectoral dialogue. Greater investor involvement in sectoral and Member State transition plans could help to develop a more sophisticated understanding of investment needs, and target public support in a way that maximises the contribution of investors.

STRENGTHENING THE FOUNDATIONS FOR SUSTAINABLE FINANCE

13. **In your opinion, which, if any, further actions would you like to see at international, EU, or Member State level to enable the financing of the sustainability transition? Please identify actions aside from the areas for future work identified in the targeted questions below (remainder of Section II), as well as the existing actions implemented as part of the European Commission's 2018 Action Plan on Financing Sustainable Growth. [BOX, 2000 characters]**

i. **Europe's Proposed Recovery Plan.** Concrete, ambitious commitments must be made in recovery instruments at EU and Member State level. Commitments to align with the EU Taxonomy would send a very strong signal that the EU and Member States are holding themselves to the same standard as investors, and increase potential synergies. The EU and Member States must also do more to connect investment needs to the most appropriate types of financing or other support.[3] A sophisticated review of capital needs and other support should be integrated into the design of EU and Member State recovery planning to maximise the opportunities for investors.

ii. **Internationalisation**. The EU and Member States should continue to advocate for high standards globally, pursuing international cooperation amongst willing Governments and investors, either through existing channels (eg. multilateral institutions) or independently if necessary. In addition, there is a clear and urgent need for harmonisation of corporate and investor disclosure requirements and Taxonomies.

iii. **Stewardship.** In some situations, stewardship is the most powerful form of leverage an investor has. Developing Europe's ambition on stewardship is a huge opportunity to harness the influence of the investment sector in support of shared goals.

iv. **Establishing a framework for impact**. The EU has started to introduce impact concepts into investor disclosure requirements, but conflicts in the legal framework remain which restrict investors' ability to integrate impact considerations.

1.1 COMPANY REPORTING AND TRANSPARENCY

14. In your opinion, should the EU take action to support the development of a common, publicly accessible, free-of-cost environmental data space for companies' ESG information, including data reported under the NFRD and other relevant ESG data?

<u>Yes</u>
No
Do not know

14.1 - If yes, please explain how it should be structured and what type of ESG information should feature therein. [BOX, 2000 characters]

These recommendations should be viewed alongside the PRI's response to the Non-Financial Reporting Directive consultation, including recommendations for the development of an EU Non-Financial Reporting Standard, with the ultimate view of global harmonisation of corporate reporting.

PRI has established a framework for understanding investor data needs. Below we list several key concepts which should inform the structure of a future EU database.

3 The Recovery Package has identified substantial investment needs on a sectoral basis. On a more granular level, this ranges from technologies that are already financed by the private sector on a wide scale (such as wind power), through to longer-term R&D projects targeting disruptive technologies which are not yet able to be financed by the private sector (such as carbon capture and storage). It also includes technologies where other forms of support, such as alignment of incentives, public procurement or standardisation (eg. pan-European harmonisation of EPC ratings for homes) would bring substantial benefits.

We recognise three core components which provide the path to comprehensively understanding an entity's ESG risks and opportunities, environmental and social performance, and contribution to wider outcomes.

Component	Explanation	Purpose
ESG risk and opportunity	ESG factors likely to impact the financial condition or operating performance of a company (financial materiality).	Provide insight into the sustainability pressures facing a business and how management is responding to them.
Sustainability performance	How a company's operations and products impact (positively and negatively) stakeholders and the environment.	Provide a comprehensive account to investors (and stakeholders) of how a company has delivered on its sustainability commitments.
Societal norms and planetary thresholds	The context within which companies operate from a sustainability perspective, includes global, national and regional targets and objectives.	Provide the necessary thresholds and targets to put sustainability performance in the context of global goals set through international agreements and frameworks. An example of this is the EU Taxonomy.

We also recognise different units of measurement (activities and entities) that are used in tracking and understanding sustainability. A portfolio approach can be taken across these categories depending on the needs of the data user.

Unit	Description
Asset-level	Data relating to physical and non-physical assets tied to company ownership information.
Economic activity	Data relating to the activities through which goods and services are produced, distributed and used.
Company	Data provided by the agent responsible for producing goods or services which has autonomy in decision-making.
Sector	Data based on a group of enterprises engaged in the same type of productive activity, irrespective of legal entity to which they belong.
Country	Data to run, monitor and evaluate operations, policies, systems and goals or targets.
Global	Agreements or legal obligations.

Regarding the specific topics, the data space should consider wider environmental, social and governance data (not be limited to environmental data as the question implies) and at a minimum align to the themes of the Sustainable Finance Disclosure Regulation, the revised NFRD (which we recommend incorporates tax matters) and the Taxonomy Regulation.

15. According to your own understanding and assessment, does your company currently carry out economic activities that could substantially contribute to the environmental objectives defined in the Taxonomy Regulation

No PRI answer.

1.2 ACCOUNTING STANDARDS AND RULES

16. Do you see any further areas in existing financial accounting rules (based on the IFRS framework) which may hamper the adequate and timely recognition and consistent measurement of climate and environmental risks?

- Yes
- No
- Do not know.

16.1 - If yes, what is in your view the most important area (please provide details, if necessary):

- Impairment and depreciation rules. [BOX, 2000 characters – Please Explain why you think this is important]
- Provision rules. [BOX, 2000 characters – Please Explain why you think this is important]
- Contingent liabilities. [BOX, 2000 characters – Please Explain why you think this is important]
- Other, please specify. [BOX, 2000 characters – Please Explain why you think this is important]

Impairment and depreciation rules

The PRI supports the view that existing financial accounting rules, in particular the IFRS Framework, are currently not paying enough attention to Environmental, Social and Governance (ESG) risks and opportunities and not sufficiently allow to asses financial material information and the relationship to business performance. Many ESG issues are financially material. Such issues should already be considered to the extent relevant to the principles and definitions of traditional financial reporting. This was also suggested in a brief recently published by International Accounting Standards Board (IASB), stating climate-related risks and other emerging issues should be considered as part of reporting against existing IFRS standards, which are mandatory in Europe.

The PRI recommends including indicators that allow assessment of a company's exposure to climate-related risks. The IAS 36 requires disclosure of the key assumptions on which cash flow projections have been based and management's approach to determining the value assigned to these key assumptions, in particular, in relation to goodwill or indefinite-life intangible assets. Where climate-related risks could significantly affect the recoverable amount of a company's assets, information about how the effect has been factored into recoverable amount calculations would be relevant for the users of the financial statements. Such information about long-lived assets and assets recognised in relation to mineral resources would be particularly relevant to users. In the extractive industries, investors may look for explanations as to whether a company has considered the effect of climate-related risks in determining whether exploration, or the evaluation of certain areas of interest, should continue.

Provision rules.

ESG issues can have an effect to the best estimate of a provision. The PRI recommends including disclosure obligations about future events and an explanation of how climate-related risks that have been factored into the best estimate of the provision. According to the before mentioned brief recently published by International Accounting Standards Board (IASB), climate-related risks could have the following effects: recognition of an onerous contract provision for the potential loss of revenues or increased costs postulated in climate-related risk scenarios considered in the best estimate; an increase of provisions recognised for decommissioning a plant or rehabilitating environmental damage in extractive industries due to regulatory changes or shortened project lives; and disclosure of a contingent liability for potential litigation and fines or penalties because of environmental and other regulations, where the company may have broken a regulation, but the probability that it will have to make a payment is lower than 50%. The PRI supports this view.

1.3 SUSTAINABILITY RESEARCH AND RATINGS

17. Do you have concerns on the level of concentration in the market for ESG ratings and data? Please express your view by using a scale of 1 (not concerned at all) to 5 (very concerned). If necessary, please explain the reasons for your answer.

- 1 - Not concerned at all
- 2 - Rather not concerned
- 3 - Neutral
- 4 - Rather concerned
- 5 - Very concerned
- Don't know / no opinion / not relevant

No PRI response.

17.1 - If necessary, please explain the reasons for your answer. [BOX, 2000 characters]

18. How would you rate the comparability, quality and reliability of ESG data from sustainability providers currently available in the market? Please express your view by using a scale of 1 (very poor) to 5 (very good). If necessary, please explain the reasons for your answer.

- 1 - Very poor
- 2 - Poor
- 3- Neutral

- 4 - Good
- 5 - Very good
- Don't know / no opinion / not relevant

Question 18.1 - If necessary, please explain the reasons for your answer. [BOX, 2000 characters]

ESG data providers each have their own specific approaches in terms of data collection processes, research methodologies and ultimately ratings. There may be good reasons for differences in ratings between service providers – for example, if the methodology adopted deliberately emphasises performance in one dimension of sustainability (for example, climate).

This is true for ESG risk and performance data. However, when we consider alignment data, the EU Taxonomy provides objective performance standards for judging whether an activity is aligned to EU goals and planetary boundaries.[4] To the extent possible, interpretive differences between data providers around the alignment of a company's activity with the Taxonomy should be minimised.

Investors should be able to scrutinise the provider's methodology and the robustness of their data collection processes, and assess their relevance to their own investment strategy.

19. **How would you rate the quality and relevance of ESG research material currently available in the market? Please express your view by using a scale of 1 (very poor) to 5 (very good). If necessary, please explain the reasons for your answer.**

    - 1 - Very poor
    - 2 - Poor
    - <u>3- Neutral</u>
    - 4 - Good
    - 5 - Very good
    - Don't know / no opinion / not relevant

20. **How would you assess the quality and relevance of ESG ratings for your investment decisions, both ratings of individual Environmental, Social or Governance factors and aggregated ones? If necessary, please explain your answer.**

No PRI answer

21. **In your opinion, should the EU take action in this area?**
    - <u>Yes</u>
    - No
    - Do not know

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[4] See question 14: PRI recognises three key components of corporate reporting: ESG risk and opportunity data, sustainability performance data and alignment with societal norms and planetary thresholds.

21.1 - If yes, please explain why and what kind of action you consider would address the identified problems. In particular, do you think the EU should consider regulatory intervention? [BOX, 2000 characters]

As above, we recognise that there may be good reasons for differences in ratings between service providers under some circumstances, although not where objective measures such as Taxonomy alignment are being assessed. Investors should be able to scrutinise the provider's methodology and the robustness of their data collection processes, and assess their relevance to their own investment strategy.

The EU could work to develop common quality guidelines to ensure transparency and set expectations for data quality and control processes, with a particular focus on increasing quality of Taxonomy-aligned data.

1.4 DEFINITIONS, STANDARDS AND LABELS FOR SUSTAINABLE FINANCIAL ASSETS AND FINANCIAL PRODUCTS

22. **The TEG has recommended that verifiers of EU Green Bonds (green bonds using the EU GBS) should be subject to an accreditation or authorisation and supervision regime. Do you agree that verifiers of EU Green Bonds should be subject to some form of accreditation or authorisation and supervision ? If necessary please explain your answer.**

No PRI response.

23. **Should any action the Commission takes on verifiers of EU Green Bonds be linked to any potential future action to regulate the market for third-party service providers on sustainability data, ratings and research?**

No PRI response.

24. **The EU GBS as recommended by the TEG is intended for any type of issuer: listed or non-listed, public or private, European or international. Do you envisage any issues for nonEuropean issuers to follow the proposed standard by the TEG?**

No PRI response.

25. **In those cases where a prospectus has to be published, do you believe that requiring the disclosure of specific information on green bonds in the prospectus, which is a single binding document, would improve the consistency and comparability of information for such instruments and help fight greenwashing? Please express your view by using a scale of 1 (strongly disagree) to 5 (strongly agree)**

No PRI response.

26. **In those cases where a prospectus has to be published, to what extent do you agree with the following statement: "Issuers that adopt the EU GBS should include a link to that**

standard in the prospectus instead of being subject to specific disclosure requirements on green bonds in the prospectus" Please express your view by using a scale of 1 (strongly disagree) to 5 (strongly agree)

No PRI response.

27. Do you currently market financial products that promote environmental characteristics or have environmental objectives?

No PRI response. (PRI does not offer financial products).

28. In its final report, the High-Level Expert Group on Sustainable Finance recommended to establish a minimum standard for sustainably denominated investment funds (commonly referred to as ESG or SRI funds, despite having diverse methodologies), aimed at retail investors. What actions would you consider necessary to standardise investment funds that have broader sustainability denominations?

- No regulatory intervention is needed.
- <u>The Commission or the ESAs should issue guidance on minimum standards.</u>
- Regulatory intervention is needed to enshrine minimum standards in law.
- Regulatory intervention is needed to create a label

29. Should the EU establish a label for investment funds (e.g. ESG funds or green funds aimed at professional investors)?

- Yes
- <u>No</u>
- Do not know

If necessary please explain your answer [2000 characters]

The EU is in the process of establishing an expanded set of fund-level disclosure obligations designed to communicate the sustainability performance of a product to end investors. In addition, the EU is proposing that investment advisors must consult retail and institutional clients on their sustainability preferences. As a priority, these reforms must support high-quality dialogue between investors and their clients around their sustainability preferences and the products they are therefore offered.

PRI supports further guidance on minimum standards. Fund labels have been deployed widely and with success by European member states, but before embarking on a new EU label, the EU should first maximise the existing reforms (above) and finalise and learn from deployment of the EU-wide Ecolabel for financial products.

If yes, regarding green funds aimed at professional investors, should this be in the context of the EU Ecolabel?

- Yes

- No
- Do not know

If necessary please explain your answer [2000 characters]

No PRI response.

30. **The market has recently seen the development of sustainability-linked bonds and loans, whose interest rates or returns are dependent on the company meeting pre-determined sustainability targets. This approach is different from regular green bonds, which have a green use-of-proceeds approach. Should the EU develop standards for these types of sustainability-linked bonds or loans? Please express your view by using a scale of 1 (strongly disagree) to 5 (strongly agree).**

No PRI response.

31. **Should such a potential standard for target-setting sustainability-linked bonds or loans make use of the EU Taxonomy as one of the key performance indicators? Please express your view by using a scale of 1 (strongly disagree) to 5 (strongly agree). If necessary please explain your answer.**

- 1 – Strongly Disagree
- 2 – Disagree
- 3 – Neutral
- 4 – Agree
- <u>5 – Strongly Agree</u>
- Don't know / no opinion

The EU Taxonomy is designed to be a common language on understanding sustainability performance, including for investable entities. The TEG recommendations clearly include the ability for the Taxonomy to be used as the basis of target-setting by corporates, and financing to bring activities in line with the Taxonomy screening criteria should be considered "Taxonomy-aligned".

Under the Taxonomy regulation, the EU is required to consider the Taxonomy in the design of any labelling system for corporate bonds (Article 4).

32. **Several initiatives are currently ongoing in relation to energy-efficient mortgages and green loans more broadly. Should the EU develop standards or labels for these types of products?**

No PRI response

- Yes
- No
- Do not know

If yes, please select all that apply:

- a broad standard or label for sustainable mortgages and loans (including social and environmental considerations);
- a standard or label for green (environmental and climate) mortgages and loans;
- a narrow standard or label only for energy-efficient mortgages and loans for the renovation of a residential immovable property;
- other: please specify what type of standard or label on sustainability in the loan market you would like to see [BOX, 2000 characters]

No PRI response

33. The Climate Benchmarks Regulation creates two types of EU climate benchmarks - 'EU Climate Transition' and 'EU Paris-aligned' - aimed at investors with climate-conscious investment strategies. The regulation also requires the Commission to assess the feasibility of a broader 'ESG benchmark'. Should the EU take action to create an ESG benchmark?

- <u>Yes</u>
- No
- Don't know.

If no, please explain the reasons for your answer, if necessary. [BOX, 2000 characters]

If yes, please explain what the key elements of such a benchmark should be. [BOX max. 2000 characters]

Given the global shift to passive, and the importance of sustainability performance alignment in this market, the PRI supports further development of ESG indices. We strongly recommend that the EU work closely with investors and benchmark administrators to ensure any future regulation builds from market experience.

HLEG identified indices and benchmarks as "cornerstones of global capital markets", with many investors relying on "indices and benchmarks for the creation of investment products, for measuring the performance of markets or investment funds, and for guiding asset allocation". The arguments in favour of the Climate Benchmarks Regulation will also apply to other sustainability themes. Furthermore, the development of the four additional environmental themes as part of the Taxonomy Regulation, as well as plans to develop a "significant harm" and social taxonomy, will provide the metrics necessary to construct benchmarks on a range of sustainability issues.

34. Beyond the possible standards and labels mentioned above (for bonds, retail investment products, investment funds for professional investors, loans and mortgages, benchmarks), do you see the need for any other kinds of standards or labels for sustainable finance?

1.5 CAPITAL MARKETS INFRASTRUCTURE

35. Do you think the existing capital market infrastructure sufficiently supports the issuance and liquidity of sustainable securities? Please express your view by using a scale of 1 (strongly disagree) to 5 (strongly agree). For scores of 1 and 2, please list the main problems you see (maximum three). [BOX, 2000 characters].

No PRI view

36. In your opinion, should the EU foster the development of a sustainable finance oriented exchange or trading segments that caters specifically to trading in sustainable finance securities and is better aligned with the needs of issuers?

- Yes
- No
- <u>Don't know.</u>

If necessary, please explain the reasons for your answer. [BOX max. 2000 characters]

Integration of sustainability risks should be a central part of all activity. As such, dedicated trading segments may reinforce the perception that integration of sustainability is a niche practice. However, there may be value development of sustainability-impact oriented capital markets infrastructure. It is not clear that regulatory intervention is necessary.

37. In your opinion, what core features should a sustainable finance–oriented exchange have in order to encourage capital flows to ESG projects and listing of companies with strong ESG characteristics, in particular SMEs?

No PRI answer

1.6 CORPORATE GOVERNANCE, LONG-TERMINISM AND INVESTOR ENGAGEMENT

38. In your view, which recommendation(s) made in the ESAs' reports have the highest potential to effectively tackle short-termism? Please select among the following options.

- Adopt more explicit legal provisions on sustainability for credit institutions, in particular related to governance and risk management;
- Define clear objectives on portfolio turn-over ratios and holdings periods for institutional investors;
- Require Member States to have an independent monitoring framework to ensure the quality of information disclosed in remuneration reports published by listed companies and funds (UCITS management companies and AIFMs);
- <u>Other, please specify. [box max. 2000 characters]</u>

Long-termism has been proposed as a way of encouraging consideration of ESG issues in investment decision-making, as the financial materiality of some issues is likely to play out over the longer-term rather than be reflected in typical short-term horizons. However, the EU's interventions to increase monitoring and management of sustainability impact/outcomes should already have the effect of encouraging consideration of sustainability. For this reason, pursuing long-termism in support of sustainability should not be considered in isolation. Defining portfolio turnover ratios or mandating holding periods for institutional investors could be counterproductive.

Nonetheless, extremely short term behaviours may warrant further intervention. High frequency trading, short selling and quarterly investor pressures can dominate share trading and hinder the growth of the underlying businesses whose shares are traded on exchanges. High frequency traders are able to buy and sell stock microseconds ahead of other investors, skimming fractions of a penny off each trade. Profits generated from this practice come at the expense of other investors in the market, particularly retail investors. There have also been complaints against HFT firms for conducting predatory strategies and studies have attributed their trading to causing and exacerbating flash crashes.

39. **Beyond the recommendations issued by the ESAs, do you see any barriers in the EU regulatory framework that prevent long-termism and/or do you see scope for further actions that could foster long-termism in financial markets and the way corporates operate?**

- <u>Yes</u>
- No
- Don't know / no opinion

If yes, please explain what action(s). [BOX max. 2000 characters]

Development and support of collaborative, outcomes-focussed investor stewardship on systemic issues such as climate change. See PRI's response to Q42.

40. **In your view, should there be a mandatory share of variable remuneration linked to non-financial performance for corporates and financial institutions?**

- Yes
- <u>No</u>
- Don't know / no opinion

If yes, please indicate what share. [box 2000 characters]

The PRI supports the alignment of executive remuneration with sustainability , as this effectively supports remuneration alignment with overall company strategy to ensure long-term value. We strongly encourage investors to consider aligning executive remuneration with sustainability, and encouraging the practice within investee companies.

However, our research has shown that the practice of integrating ESG issues into executive remuneration is in its infancy. It is hindered by the lack of a universally accepted standard of reference for boards, senior executives and remuneration consultants to assess relevant ESG risks, opportunities, performance and alignment with goals. In addition, the current weaknesses in data provision make it extremely difficult for investors to consistently and accurately assess the sustainability performance of corporates or financial institutions in Europe, and hence alignment with overall strategy. Finally, we have not identified any evidence that mandating a specific share of variable remuneration to be linked to pay addresses the issues above constructively.

The EU should strengthen expectations for corporates and financial institutions to integrate sustainability metrics into executive remuneration, but we do not consider it appropriate to mandate a specific share at this stage.

41. Do you think that a defined set of EU companies should be required to include carbon emission reductions, where applicable, in their lists of ESG factors affecting directors' variable remuneration?

- <u>Yes</u>
- No
- Don't know / no opinion

As above, integration of sustainability into executive remuneration is in its infancy, but we do consider it important that companies performing environmentally harmful activities should establish transition plans, and that remuneration should be aligned with measurable progress and milestones regarding these plans.

42. Beyond the Shareholder Rights Directive II, do you think that EU action would be necessary to further enhance long-term engagement between investors and their investee companies?

- <u>Yes</u>
- No
- Do not know

If yes, what action should be taken? Please explain or provide appropriate examples. [BOX max. 2000 characters]

Development and support of collaborative, outcomes-focussed investor stewardship on systemic issues such as climate change should be central to the revised Sustainable Finance strategy.

Stewardship should be recognised as a tool for management of sustainability risks and impacts, and fully integrated into EU investor disclosure rules and product labelling schemes. Below, we identify some further clarifications to the existing framework, as well as new initiatives:

i. <u>Clarifications to existing framework (SRD II, UCITS, Acting in Concert)</u>

The Shareholder Rights Directive (SRD II) provides a minimum baseline for stewardship activities, effective stewardship and long-term investment decision making. It does not set expectations for how different actors across the investment chain should discharge their stewardship responsibilities and it does not reflect global best practice in stewardship guidelines. SRD II should be revised or supplemented to ensure that:

- Investors clarify the intended overall objective of their stewardship activities (for example, to maximise performance of individual holdings, to maximise performance of the portfolio overall, or to maximise net financial (and/or non-financial) benefits to client/beneficiaries;
- Stewardship is recognised as a possible tool across all asset classes; and
- Sustainability is recognised as a central component of stewardship.

The UCITS Delegated Directive requires that management companies develop strategies for exercise of voting rights to the exclusive benefit of the UCITS concerned.[5] The best interests of the UCITS is defined primarily by the investment policy, which may include sustainability objectives. In the absence of defined sustainability objectives, the best interest is determined primarily in relation to financial return. Unless there is a clear financial benefit expected, costs incurred pursuing sustainability objectives through voting and engagement may be considered incompatible with acting in the 'best interests' of the UCITS.

The EU should also consider further development of ESMA guidance and work with national regulators to ensure acting in concert and anti-trust regulations do not impede collaborative engagement by investors around common sustainability goals.

ii. <u>Aspirational standards for stewardship</u>

The EU should establish an aspirational (non-binding) standard for outcomes-focused stewardship and the development and adoption of a standard for system-level stewardship, where efforts are focused on achievement of outcomes on common goals rather than on outperformance of individual assets.

43. Do you think voting frameworks across the EU should be further harmonised at EU level to facilitate shareholder engagement and votes on ESG issues?

- <u>Yes</u>
- No
- Do not know

Diverging regulation at EU member state level, and the manual processes it requires, can be a barrier for shareholder engagement and voting. Harmonisation of voting frameworks, particularly around cut-off dates; timings between receipt of meeting material and voting deadlines; and automatic vote confirmation could ease the burden and allow investors greater capacity to consider the substance of the issues.

[5] Article 21(1) of Delegated Directive 2010/43/EU

Harmonisation could also allow greater ease in processes like the filing of shareholder resolutions, which are an increasingly important tool for investors to communicate their expectations to companies and thus to catalyse greater action of ESG factors and risks. This process also suffers from diverging regulations in different markets across the EU.

44. Do you think that EU action is necessary to allow investors to vote on a company's environmental and social strategies or performance?

- <u>Yes</u>
- No
- Do not know / no opinion

If yes, please explain. [BOX max. 2000 characters]

Further action is necessary, but must be carefully designed.

Voting is an efficient and transparent tool for investors to communicate with investees. Currently, there is no consistent way for investors to directly opine on a company's ESG performance. However, investors who wish to express their views with a company's ESG performance can, and do, make use of existing tools such as voting against board members, on the annual report, and executive pay. In practice, many investors challenge companies on the absence of sustainability strategies rather than the contents of their strategies.

The EU must first establish clear frameworks for understanding the resilience of businesses to physical and transition risks, understanding the social and environmental performance and due diligence efforts of companies, and understanding the alignment of company activities with EU and international goals, such as The Paris Agreement. Reform of the NFRD is central to this, and should encourage integration of these issues into core business strategy and reporting.

The EU should consider whether it would be more impactful to strengthen expectations of investors (e.g. requiring them to consider the sustainability strategy and disclosures when deciding whether to vote in favour of the annual report) or to mandate a separate vote on a sustainability strategy. A separate vote could run the risk of encouraging investors and companies to treat ESG performance and alignment as separate from the company's long term business strategy, and may be ineffective if poorly designed. For example, if it fails to address the full implications of a company's strategy (including externalised or outsourced sustainability impacts), if it does not adequately address the alignment of a company's performance with EU and global sustainability goals, and if it is not supported by adequate risk, disclosure and audit requirements.

45. Do you think that passive index investing, if it does not take into account ESG factors, could have an impact on the interests of long-term shareholders?

- <u>Yes</u>
- No
- Do not know.

If no, please explain the reasons for your answer if necessary. [BOX max. 2000 characters]

If yes, in your view, what do you think this impact is, do you think that the EU should address it and how? [box max. 2000 characters]

As with all investment products, failure to take into account financially material factors, including ESG factors, may cause the mispricing of risk and poor asset allocation decisions. Index providers should incorporate ESG factors into the construction of indices and benchmarks. Asset owners following passive strategies should encourage index providers or asset managers to incorporate ESG risks in the construction of indices as well as their selection. There are a number of challenges, such as index complexity, index and fund transparency, and how to compare between ESG indices.[6] The PRI recommends minimum transparency expectations for ESG indices.

Furthermore, the growth in passive investing leads to system effects and implications for sustainability. Research by PRI demonstrates concentration of power in the passive fund management industry which is dominated by a small number of powerful managers, with most asset owners reduced to product-takers.[7]

The PRI recommends further research on the financial system effects of passive and implications for sustainability. The research will look at 'tipping points' – the implications of 'blind capital' in market oversight, too big to fail, the role of efficient market hypothesis – and consider what this means for sustainability goals, including towards 1.5 degrees.

46. Due regard for a range of 'stakeholder interests', such as the interests of employees, customers, etc., has long been a social expectation vis-a-vis companies. In recent years, the number of such interests have expanded to include issues such as human rights violations, environmental pollution and climate change. Do you think companies and their directors should take account of these interests in corporate decisions alongside financial interests of shareholders, beyond what is currently required by EU law?

- <u>Yes, a more holistic approach should favour the maximisation of social, environmental, as well as economic/financial performance.</u>
- Yes, as these issues are relevant to the financial performance of the company in the long term.
- No, companies and their directors should not take account of these sorts of interests.
- I do not know.

47. Do you think that an EU framework for supply chain due diligence related to human rights and environmental issues should be developed to ensure a harmonised level-playing field, given the uneven development of national due diligence initiatives?

- <u>Yes</u>
- No
- Do not know / no opinion

[6] See: https://www.unpri.org/passive-investment/esg-and-passive-investment-strategies/5493.article
[7] https://www.unpri.org/download?ac=1398

Mandatory due diligence across a company's whole operations (including, but not limited to, supply chains), including a requirement to report publicly, will substantially improve the relevant, comparable information available to investors making them better able to allocate capital and conduct stewardship activities in a way that's aligned with the EU's policy goals in relation to the Paris Agreement, the Sustainable Development Goals and international human rights standards.

The PRI fully supports EU-wide implementation of mandatory due diligence covering both human rights and environmental impacts. This should use the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights as the basis for this implementation. This would align implementation with other EU policy frameworks including the EU's approach to Corporate Social Responsibility, the EU Taxonomy and the Regulation on Sustainability-Related Disclosures in the Financial Sector (which draws key concepts from the OECD guidelines on responsible business conduct for institutional investors aligned to the MNEs guidelines). Using these internationally recognised frameworks, in a consistent approach, would also support international alignment and harmonisation and thus secure a level-playing field for companies operating in the Single Market

48. Do you think that such a supply chain due diligence requirement should apply to all companies, including small and medium sized companies?

- <u>Yes</u>
- No
- Do not know.

If yes, please select your preferred option:

- All companies, including SMEs.
- <u>All companies, but with lighter minimum requirements for SMEs.</u>
- Only large companies in general, and SMEs in the most risky economic sectors sustainability-wise.
- Only large companies.

If necessary, please explain the reasons for your answer. [box max. 2000 characters]

The OECD guidelines include a principle of proportionality, meaning they are adaptable to different sizes and types of business including SMEs.

2. INCREASING OPPORTUNITIES FOR CITIZENS, FINANCIAL INSTITUTIONS AND CORPORATES TO ENHANCE SUSTAINABILITY

2.1 MOBILISING RETAIL INVESTORS AND CITIZENS

49. In order to ensure that retail investors are asked about their sustainability preferences in a simple, adequate and sufficiently granular way, would detailed guidance for financial advisers be useful when they ask questions to retail investors seeking financial advice?

- <u>Yes</u>
- No
- Do not know / no opinion

50. Do you think that retail investors should be systematically offered sustainable investment products as one of the default options, when the provider has them available, at a comparable cost and if those products meet the suitability test?

- <u>Yes</u>
- No
- Do not know / no opinion

Suitability assessment in line with MiFID II is an important concept in understanding and acting in the best interests of clients and hence fulfilling fiduciary duties. The PRI supports the HLEG recommendations on fiduciary duty which embed an expectation that firms will respond, to the extent possible, to a client's sustainability preferences. As such, it is reasonable that a provider would offer products which respond to the client's preferences, assuming all other relevant tests are met.

51. Should the EU support the development of more structured actions in the area of financial literacy and sustainability, in order to raise awareness and knowledge of sustainable finance among citizens and finance professionals? Please reply using a scale of 1 (completely disagree) to 5 (fully agree)

<u>PRI answer: 4</u>

i. If you agree (for scores of 4 to 5), please choose what particular action should be prioritised:
    a. Integrate sustainable finance literacy in the training requirements of finance professionals. [1-5]
    b. Stimulate cooperation between Member States to integrate sustainable finance as part of existing subjects in citizens' education at school, possibly in the context of a wider effort to raise awareness about climate action and sustainability.[1-5]
    c. Beyond school education, stimulate cooperation between Member States to ensure that there are sufficient initiatives to educate citizens to reduce their environmental footprint also through their investment decisions. [1-5]

d. Directly, through targeted campaigns. [1-5]
e. As part of a wider effort to raise the financial literacy of EU citizens. [1-5]
f. As part of a wider effort to raise the knowledge citizens have of their rights as consumers, investors, and active members of their communities. [1-5]
g. Promote the inclusion of sustainability and sustainable finance in the curricula of students, in particular future finance professionals. [1-5]
h. <u>Other, please explain.[box max. 2000 characters]</u>

The EU should focus on establishing an expectation that investment professionals, trustees and senior managers have the necessary skills and understanding to discharge their responsibilities in relation to sustainability. The EU High Level Expert Group on Sustainable Finance recognised that executive and supervisory governing bodies (of both businesses and investors) need to understand sustainability drivers and their relationship to business models.

We support the HLEG's recommendation to update the 'fit and proper' tests'[8] to include an assessment of the individual and collective ability of the members of governing bodies in financial institutions to address sustainability risks, to understand the broader stakeholder context and to take account of clients' sustainability preferences. Supervisory manuals should be updated to include sustainability as a risk against which the skills and competences of the members of the governing bodies of companies should be assessed. In addition, internal governance requirements in sector-specific regulations should be updated to reflect the need for competencies related to: identifying and addressing long term risks including sustainability risks; understanding the broader stakeholder context; and understanding and responding to clients' sustainability preferences.

2.2 BETTER UNDERSTANDING THE IMPACT OF SUSTAINABLE FINANCE ON SUSTAINABILITY FACTORS

52. In your view, is it important to better measure the impact of financial products on sustainability factors? Please express your view by using a scale of 1 (not important at all) to 5 (very important).

<u>PRI response: 5 Very important.</u>

For scores of 4 to 5, what actions should the EU take in your view? [BOX max. 2000 characters]

The EU has the EU Taxonomy and the Regulation on Sustainability-Related Disclosures in the Financial Sector, both of which set frameworks for understanding the impact of financial products on sustainability. These regulations affect the same firms and funds and embed similar concepts (such as making a substantial contribution to sustainability objectives while avoiding significant harm). Both also build from the OECD Guidelines on Responsible Business Conduct for Institutional Investors.

The EU should consider development and greater integration of these regulations. Any impact-based metrics should:

[8] See page 39 for a detailed list: https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report_en.pdf

- reflect the OECD RBC Guidelines framework for understanding investor impact (cause, contribute, or be directly linked to) rather than reflect the characteristics of the underlying investment, and
- contextualise the impact in relation to Union goals and laws, such as climate neutrality.

53. Do you think that all financial products / instruments (e.g. shares, bonds, ETFs, money market funds) have the same ability to allocate capital to sustainable projects and activities?

- Yes
- No
- Do not know

If no, please explain what you would consider to be the most impactful products/instruments to reallocate capital in this way.[box max. 2000 characters]

There is a significant difference in the ability of different financial instruments to directly allocate capital to sustainable activities. However, focussing on capital allocation ignores the other possible ways investors can contribute to sustainability outcomes.

With the exception of cash, there is no simple answer as to whether a financial product or instrument has the same ability to contribute to sustainability objectives. Each has different levers at their disposal and these may depend on the strategy the provider or issuer is pursuing (for example, whether a sovereign is issuing a green bond).

When considering the potential impact, the Commission should also consider the typical asset mix of institutional investors, with each asset class carrying different opportunities for contribution to sustainability outcomes. For example, amongst the PRI's membership[9], the vast majority of assets under management are in listed equity (38%) and fixed income (40% comprised sovereign, supranational and agency – 18%, corporate – 18% , securitisations – 4%).[10]

Finally, it is worth noting that investors are also not the only providers of capital. National and municipal governments, multilateral financial institutions, corporations (via their own strategies and associated capital allocation plans) and even citizens (eg. via crowd funding) can all play a substantial role in allocating capital to sustainable projects.

2.3 GREEN SECURITISATION

54. Do you think that green securitisation has a role to play to increase the capital allocated to sustainable projects and activities? Please express your view by using a scale of 1 (not important at all) to 5 (very important).

[9] Figures correct as of 2017.

[10] While important, private equity (3%), property (4%) and infrastructure (1%) correspond to much smaller volumes.

PRI response - 3

While there is large-scale financing required, some parts of the low-carbon transition will require small scale financing (eg. loans for electric vehicles and charging infrastructure, green mortgages and loans covering domestic renovation and installation of micro-renewables). Transport and buildings make up a substantial part of the EU's emissions.

55. Do the existing EU securitisation market and regulatory frameworks, including prudential treatment, create any barriers for securitising 'green assets' and increasing growth in their secondary market?

No PRI response.

56. Do you see the need for a dedicated regulatory and prudential framework for 'green securitisation'?

No PRI response.

2.3 DIGITAL SUSTAINABLE FINANCE

57. Do you think EU policy action is needed to maximise the potential of digital tools for integrating sustainability into the financial sector?

No PRI response.

58. Do you consider that public authorities, including the EU and Member States should support the development of digital finance solutions that can help consumers and retail investors to better channel their money to finance the transition?

- Yes
- No
- Do not know

No PRI response.

If yes, please explain what actions would be relevant from your perspective and which public authority would be best-positioned to deliver it. Please list a maximum of three actions [BOX max. 2000 characters]

59. In your opinion, should the EU, Member States, or local authorities use digital tools to involve EU citizens in co-financing local sustainable projects?

- Yes
- No
- Do not know

If yes, please detail, in particular if you see a role for EU intervention, including financial support. [BOX max. 2000 characters]

No PRI response.

2.5 PROJECT PIPELINE

60. What do you consider to be the key market and key regulatory obstacles that prevent an increase in the pipeline of sustainable projects? Please list a maximum three for each. BOX max. 2000 characters

Regulatory

Implementation plans for major sectoral net-zero transitions should be established. This should include analysis and securing of supply chain components, skills and workforce development, subsidy alignment, regulatory approval process alignment in order to ensure that necessary green markets can function in practice. Specific barriers are listed below:

i. The EU's investment needs are communicated at a high level but are not developed in a granular way, or with a clear articulation of the different types of financing or other support necessary for each sector. A sophisticated review of capital needs and other forms of support should be integrated into the design of EU and Member State recovery planning (including NECPs, which will form part of the assessment for Recovery and Resilience Plans).

ii. Incentives, such as fossil fuel subsidies, or weaknesses in carbon markets, distort the business case for investment in low-carbon alternatives. Again, NECPS – which are required to state plans for phase out of fossil fuel subsidies – should be central to this.

iii. Lack of standardisation across Europe – for example, differences in relative ambition of buildings energy frameworks – increases barriers for investors seeking a Europe-wide approach.

Market

iv. We recommend the development of further technical assistance to project promoters, and to aid in the aggregation of projects to reach the necessary scale for institutional investment.

v. The EU should encourage greater knowledge sharing between EIB and other public and private financial institutions, serving as a repository of expertise in low-carbon financing and tracking, including the InvestEU climate proofing methodology.

vi. The EU could also review the role of public private partnerships, considering whether improvements in transparency and measurement criteria could increase their contribution, where appropriate. The HLEG further recommended advancing the use of standardised public-private partnership contracts where possible.

61. **Do you see a role for Member States to address these obstacles through their NECPs (National Energy and Climate Plans)?**

- <u>Yes</u>
- No
- Do not know

62. **In your view, how can the EU facilitate the uptake of sustainable finance tools and frameworks by SMEs and smaller professional investors? Please list a maximum of three actions you would like to see at EU-level**

No PRI response.

63. **The transition towards a sustainable economy will require significant investment in research and innovation (R&I) to enable rapid commercialisation of promising and transformational R&I solutions, including possible disruptive and breakthrough inventions or business models. How could the EU ensure that the financial tools developed to increase sustainable investment flows turn R&I into investable (bankable) opportunities? [Box max. 2000 characters]**

The approach should recognise the differing capital needs a company has at different stages of its lifecycle. Moving from concept to maturity may rely on a combination of self-financing, grants, seed financing and multiple rounds of venture capital financing. This is, by nature, a long-term and risky process.

The need for targeted support for innovative technologies should be considered when assessing capital needs in the context of EU and Member State recovery planning.

The EU can support the demand for low-carbon solutions by establishing a clear and predictable framework for ensuring a low-carbon transition.

64. **In particular, would you consider it useful to have a category for R&I in the EU Taxonomy?**

- <u>Yes</u>
- No
- Don’t know

The EU Taxonomy establishes technology-neutral performance thresholds. Innovative technologies which can help in the attainment of these thresholds can already be counted as “green” for the purposes of Taxonomy reporting already, and as such no additional category is required for these activities. However, there could be some merit in developing a category for pre-commercial technology development.

65. **In your view, do you consider that the EU should take further action in:**

- Bringing more financial engineering to sustainable R&I projects?
- Assisting the development of R&I projects to reach investment-ready stages, with volumes, scales, and risk-return profiles that interest investors (i.e. ready and bankable projects that private investors can easily identify)?
- Better identifying areas in R&I where public intervention is critical to crowd in private funding?
- Ensuring alignment and synergies between Horizon Europe and other EU programmes/funds?
- Conducting more research to address the high risks associated with sustainable R&I investment (e.g. policy frameworks and market conditions)?
- Identifying and coordinating R&I efforts taking place at EU, national and international levels to maximise value and avoid duplication?
- Facilitating sharing of information and experience regarding successful low-carbon business models, research gaps and innovative solutions?
- Increasing the capacity of EU entrepreneurs and SMEs to innovate and take risks?

2.6 INCENTIVES TO SCALE UP SUSTAINABLE INVESTMENTS

66. In your view, does the EU financial system face market barriers and inefficiencies that prevent the uptake of sustainable investments? Please express your view on the current market functioning by using a scale of 1 (not well functioning at all) to 5 (functioning very well). Please specify your answer. [BOX max. 2000 characters]

PRI response - 2

67. In your view, to what extent would potential public incentives for issuers and lenders boost the market for sustainable investments? Please express your view on the importance of financial incentives by using a scale of 1 (not effective at all) to 5 (very effective).

Please express your view on the importance of financial incentives by using a scale of 1 (not effective at all) to 5 (very effective).

PRI response - 3

In case you see a strong need for public incentives (scores of 4 to 5), which specific incentive(s) would support the issuance of which sustainable financial assets, in your view? Please rank their effectiveness using a scale of 1 (not effective at all) to 5 (very effective).

Types of incentives

- Bonds
- Loans
- Equity
- Other
- Revenue-neutral subsidies for issuers
- De-risking mechanisms such as guarantees and blended financing instruments at EU-level

- Technical Assistance
- Any other public sector incentives – Please specify in the box below

Please specify the reasons for your answer (provide if possible links to quantitative evidence) and add any other incentives you would like the Commission to consider. [BOX max. 2000 characters]

Targeted incentives can support the development and deployment of sustainable technologies. Subsidies, guarantees and blended finance should all be considered in the context of Europe's financing needs.

Issuance of sovereign green bonds can be a powerful tool to support the creation of green capital markets.

68. In your view, to what extent would potential incentives for investors (including retail investors) help create an attractive market for sustainable investments? Please express your view by using a scale of 1 (not effective at all) to 5 (very effective).

PRI response: 2

For scores of 4 to 5, in case you see a strong need for incentives for investors, which specific incentive(s) would best support an increase in sustainable investments? [drop down menu]

- Revenue-neutral public sector incentives
- Adjusted prudential treatment
- Public guarantee or co-financing
- Other

Please specify the reasons for your answer (provide if possible links to quantitative evidence) and the category of investor to whom it should be addressed (retail, professional, institutional, other). [BOX max. 2000 characters]

No PRI response

69. In your view, should the EU consider putting in place specific incentives that are aimed at facilitating access to finance for SMEs carrying out sustainable activities or those SMEs that wish to transition?

No PRI response

2.7 THE USE OF SUSTAINABLE FINANCE TOOLS AND FRAMEWORKS BY PUBLIC AUTHORITIES

70. In your view, is the EU Taxonomy, as currently set out in the report of the Technical Expert Group on Sustainable Finance, suitable for use by the public sector, for example in order to classify and report on green expenditures?

- Yes - please explain which public authority could use it, how and for what purposes. [Box max. 2000 characters]

The EU, Member States, municipal governments and public finance institutions.

The High Level Expert Group on Sustainable Finance, which recommended the EU develop such a Taxonomy, originally envisaged a wide range of uses spanning public and private actors. This included (but was not limited to):

1. Measuring financial flows towards sustainable development priorities at the asset, portfolio, institutional, regional, national and European levels.
2. Identifying assets that qualify for financing under European climate and/or green and/or sustainable funding mechanisms.
3. Supporting investor engagement with companies around their business models and transition plans.

The Taxonomy has been precisely tailored to identify investments that can deliver on the EU's environment and climate objectives, and to identify activities at risk of causing substantial harm to progress against those objectives. The TEG, comprised of representatives of a wide range of stakeholders including public and private financial institutions, has considered a wide range of possible applications when making recommendations on the design of the Taxonomy.

In particular, we see a role for the Taxonomy in Europe's proposed Recovery plan (Multiannual Financial Framework and Next Generation EU) climate mainstreaming commitments and "do no harm" oath. For example, the Taxonomy should be considered in the Recovery and Resilience Facility, the Solvency Support Instrument, regional development funding, HorizonEurope, the Just Transition Mechanism and InvestEU incorporating the new Strategic Investment Facility.

Aligning the recovery plans to the Taxonomy would also enable the issuance of Sovereign green bonds aligned with the proposed EU Green Bond Standard.

- Yes, but only partially - please explain which public authority could use it, how and for what purposes, as well as the changes what would be required to make it fit for purpose. [Box max. 2000 characters]
- No - please explain why you consider that it is not suitable for use by public authorities, and how those reasons could be best addressed in your view. [Box max. 2000 characters]
- Do not know.

71. In particular, is the EU Taxonomy, as currently set out in the report of the Technical Expert Group on Sustainable Finance, suitable for use by the public sector in the area of green public procurement?

- Yes
- Yes, but only partially
- No

- Do not know

If no or yes, but only partially, please explain why and how those reasons could be best addressed. [BOX max. 2000 characters]

We are not aware of any specific reason it would not be applicable.

72. In particular, should the EU Taxonomy play a role in the context of public spending frameworks at EU level, i.e. EU spending programmes such as EU funds, Structural and Cohesion Funds and EU state aid rules, where appropriate? Please select all that apply

- <u>Yes, the taxonomy with climate and environmental objectives set out in the Taxonomy Regulation;</u>
- Yes, but only if social objectives are incorporated in the EU Taxonomy, as recommended by the TEG, and depending on the outcome of the report that the Commission must publish by 31 December 2021 in line with the review clause of the political agreement on the Taxonomy Regulation.
- No;
- Do not know.

If yes, what role should it play and is the taxonomy, as currently set out in the report of the Technical Expert Group on Sustainable Finance, suitable for the following purposes? Select all that apply:

- <u>In the context of some EU spending programmes: BOX [max 2000 characters]</u>

It is hard to separate EU spending programmes from the wider recovery package, combined of the Multiannual Financial Framework and Next Generation EU.

The Taxonomy has been precisely tailored to identify investments that can deliver on the EU's environment and climate objectives, and to identify activities at risk of causing substantial harm to progress against those objectives. The TEG, comprised of representatives of a wide range of stakeholders including public and private financial institutions, has considered a wide range of possible applications when making recommendations on the design of the Taxonomy.

The Taxonomy should be considered in the context of climate mainstreaming commitments under the MFF. We also see a role for the Taxonomy in fulfilling the "do no harm" oath of the proposed Recovery Package, supporting the green transition through the Recovery and Resilience Facility, the Solvency Support Instrument, regional development funding, HorizonEurope, the Just Transition Mechanism and InvestEU incorporating the new Strategic Investment Facility.

Aligning the recovery plans to the Taxonomy would also enable the issuance of Sovereign green bonds aligned with the proposed EU Green Bond Standard.

- <u>In the context of EU state aid rules: BOX [max 2000 characters]</u>

All forms of EU state aid, and in particular the Projects of Common Interest list, should be aligned to the EU's long term goals and therefore fully aligned to the EU Taxonomy.

- Other, please specify. BOX [max. 2000 characters]

As above – Next Generation EU.

If yes, but only if social objectives are included; what role do you see for a social, climate and environmental taxonomy? Select all that apply.

- In the context of some EU spending programmes: BOX [max 2000 characters]
- In the context of EU state aid rules: BOX [max 2000 characters]
- Other, please specify. BOX [max. 2000 characters]

73. Should public issuers, including Member States, be expected to make use of a future EU Green Bond Standard for their green bond issuances, including the issuance of sovereign green bonds in case they decide to issue this kind of debt?

- Yes
- No
- Do not know

2.3 PROMOTING INTRA-EU CROSS-BORDER SUSTAINABLE INVESTMENTS

74. Do you consider that targeted investment promotion services could support the scaling up of cross-border sustainable investments?

No PRI response

2.9 EU INVESTMENT PROTECTION FRAMEWORK

75. Do you consider that the investment protection framework has an impact on decisions to engage in cross-border sustainable investment? Please choose one of the following:

No PRI response

2.10 PROMOTING SUSTAINABLE FINANCE GLOBALLY

76. Do you think the current level of global coordination between public actors for sustainable finance is sufficient to promote sustainable finance globally as well as to ensure coherent frameworks and action to deliver on the Paris Agreement and/or the UN Sustainable Development Goals (SDGs)? Please express your view by using a scale of 1 (highly insufficient) to 5 (fully sufficient).

PRI view – 2.

For scores of 1-2, what are the main missing factors at international level to further promote sustainable finance globally and to ensure coherent frameworks and actions? [BOX max. 2000 characters]

We would differentiate between The Paris Agreement (3) and the UN Sustainable Development Goals (1) .

International climate diplomacy has well-established governance and coordination through the Conference of the Parties, which ultimately led to The Paris Agreement. However, we would like to see greater ambition from National governments in development of robust Nationally Defined Contributions (NDCs) and more coherence on frameworks for supporting private investment to contribute fully to the realisation of The Paris Agreement, including harmonisation of corporate and investor reporting rules and Taxonomies.

By contrast, we find the level of global coordination around the Sustainable Development Goals and the Addis Ababa Action Agenda (sustainable development financing framework) to be much lower.

77. What can the Commission do to facilitate global coordination of the private sector (financial and non-financial) in order to deliver on the goals of the Paris Agreement and/or SDGs? Please list a maximum of three proposals. [BOX max. 2000 characters]

The EU and Member States should:

i. Advocate for the highest levels of ambition in advance of COP 26, supported by high-ambition implementation of the EU's own Climate Law and proposed Recovery Plan.
ii. Support and advance international dialogue around global harmonisation of Non-Financial Reporting Standards and Taxonomies, through the International Platform on Sustainable Finance or other channels as appropriate (noting that the Platform is not a standard setting body and while it can facilitate dialogue between Governments, it may not be appropriate to task it with the ongoing development and management of reporting standards).
iii. Further develop the social dimension of existing sustainability and sustainable finance tools. European developments have wide-ranging international implications and can provide inspiration for other countries.

78. In your view, what are the main barriers private investors face when financing sustainable projects and activities in emerging markets and/or developing economies? Please select all that apply.

- <u>Lack of internationally comparable sustainable finance frameworks (standards, taxonomies, disclosure, etc.);</u>
- Lack of clearly identifiable sustainable projects on the ground;
- Excessive (perceived or real) investment risk;
- <u>Difficulties to measure sustainable project achievements over time;</u>
- <u>Other, please specify [BOX max. 2000 characters].</u>

i. Lack of data.

ii. Institutional investor capacity (such as market familiarity, professional experience, language barriers)

79. **In your opinion, in the context of European international cooperation and development policy, how can the EU best support the mobilisation of international and domestic private investors to finance sustainable projects and activities in emerging markets and developing countries, whilst avoiding market distortions? Please provide a maximum of three proposals. [BOX max. 2000 characters]**

80. **How can EU sustainable finance tools (e.g. taxonomy, benchmarks, disclosure requirements) be used to help scale up the financing of sustainable projects and activities in emerging markets and/or developing economies? Which tools are best suited to help increase financial flows towards and within these countries and what challenges can you identify when implementing them? Please select among the following options.**

- All EU sustainable finance tools are already suitable and can be applied to emerging markets and/or developing economies without any change.
- <u>Some tools can be applied, but not all of them. If necessary, please explain [box max. 2000 characters].</u>

The TEG's recommendations for the EU Taxonomy already take into account the application of the Taxonomy beyond Europe's borders, including in emerging markets, and in situations where insufficient data is available (as is commonly reported by investors in emerging markets). The existing Taxonomy responds to the environmental profile of the European economy, and as such may require additional activities to be added to the scope. Fundamentally, however, it can be used to assess a net-zero transition, or improvements in climate resilience, in any market.

We have not considered the application of the other tools.

- These tools need to be adapted to local specificities in emerging markets and/or developing economies. Please explain how you think they could be adapted [box max. 2000 characters].
- Do not know.

81. **In particular, do you think that the EU Taxonomy is suitable for use by development banks, when crowding in private finance, either through guarantees or blended finance for sustainable projects and activities in emerging markets and/or developing economies?**

- <u>Yes</u>
- Yes, but only partially
- No
- Do not know.

If no or yes, but only partially, please explain why and how the obstacles you identify could be best addressed [box max. 2000 characters].

The EU Taxonomy is designed to apply to a wide range of types of financing and builds from the IFI/MDB framework.

3. REDUCING AND MANAGING CLIMATE AND ENVIRONMENTAL RISKS

3.1 IDENTIFYING EXPOSURES TO HARMFUL ACTIVITIES AND ASSETS AND DISINCENTIVISING ENVIRONMENTALLY HARMFUL INVESTMENTS

82. In particular, do you think that existing actions need to be complemented by the development of a taxonomy for economic activities that are most exposed to the transition due to their current negative environmental impacts (the so-called "brown taxonomy") at EU level, in line with the review clause of the political agreement on the Taxonomy Regulation?

- <u>Yes</u>
- No
- Do not know.

If no, please explain why you disagree [BOX max. 2000 characters]

If yes, what would be the purpose of such a brown taxonomy? (select all that apply)

- <u>Help supervisors to identify and manage climate and environmental risks.</u>
- <u>Create new prudential tools, such as for exposures to carbon-intensive industries.</u>
- <u>Make it easier for investors and financial institutions to voluntarily lower their exposure to these activities.</u>
- <u>Identify and stop environmentally harmful subsidies.</u>
- Other, please specify. [box max. 2000 characters]

A simple answer is that a "significant harm" Taxonomy already exists[11]. The Taxonomy regulation requires the EU to establish screening criteria for determining how an activity can avoid significant harm, as well as the better-known positive criteria. The delegated acts containing technical screening criteria due by the end of 2020 will embed "substantial contribution" and "significant harm" criteria.

The question is therefore how this should be used. The Taxonomy was originally envisaged as having a wide range of uses spanning public and private actors. This included (but was not limited to):

1. Measuring financial flows towards sustainable development priorities at the asset, portfolio, institutional, regional, national and European levels.
2. Identifying assets that qualify for financing under European climate and/or green and/or sustainable funding mechanisms.

---

[11] We strongly recommend that the EU and other stakeholders move away from referring to a significant harm taxonomy as "brown".

3. Supporting investor engagement with companies around their business models and transition plans.

A “significant harm” Taxonomy can therefore be used in many ways, including:

- Fulfilling the proposed EU Recovery plan “do no harm” oath – that public financing should not undermine progress on Europe’s sustainability goals.
- Supporting the deployment of the proposed Solvency Support Instrument which would require companies with harmful environmental performance to establish transition plans as a condition of any assistance. The SH Taxonomy could help in both identification and transition planning (by transitioning away from significant harm).

Considering investor disclosure, the concepts of “adverse impacts” and “significant harm” are embedded across investor disclosure requirements and are increasingly important in the context of connecting environmental performance to the attainment of real-world goals such as climate neutrality. Under current proposals, investors would be required to disclose on a separate framework for understanding each of these concepts – a burdensome and duplicative process. The Taxonomy should be considered as a tool for this purpose.

Finally, although we see the Taxonomy as primarily a tool for understanding environmental performance, exposure to highly polluting assets can also be used as a proxy for transition risk. The Network for Greening the Financial System has called for the development of “harm” taxonomies. Indeed, supervisors are already developing methodologies to assess these risks. The Taxonomy takes a sophisticated, science-based and technology neutral approach to identification of these activities and should be studied for use in this way.

83. Beyond a sustainable and a brown taxonomy, do you see the need for a taxonomy which would cover all other economic activities that lie in between the two ends of the spectrum, and which may have a more limited negative or positive impact, in line with the review clause of the political agreement on the Taxonomy Regulation?

- Yes
- <u>No</u>
- Do not know

If yes, what should be the purpose of such a taxonomy? Please specify. [BOX max. 2000 characters]

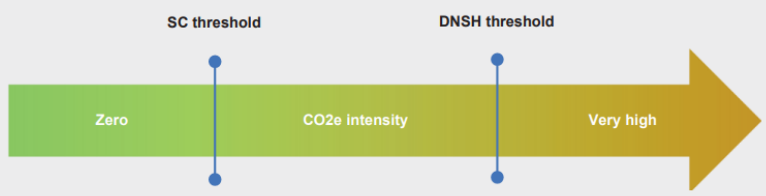
We support greater differentiation between activities which cause significant harm and the middle category of activities which neither cause significant harm nor make a substantial contribution.

The existing framework already creates three “levels”:

- Activities making a substantial contribution
- Neutral or low impact activities.
- Activities causing significant harm

An example of this for a sector with a substantial carbon profile is given below (see Figure 14 of the TEG final report).

Figure: 14 Example of quantitative SC and DNSH criteria[52]



This framework also allows for differentiation between activities causing significant harm, those causing a positive contribution, and those that are effectively neutral. This is increasingly important for companies whose environmental profile is not significant in the context of the EU's environmental goals, but who are nonetheless undertaking good environmental management practices and wish to be differentiated from companies performing harmful activities.

However, we do not support the creation of further levels or "shades of green".

To make a substantial contribution to climate change mitigation, an activity must demonstrate that it is aligned to Europe's climate neutrality objective. The EU Taxonomy recognises different routes for this, including activities already aligned with net-zero and those in transition (I.e. activities with a substantial emissions profile and where net-zero performance is not yet possible).

An activity can qualify if it is in transition. But it must be on a credible, robust transition pathway to net-zero by 2050, and this is the basis of the Taxonomy criteria.

If it cannot demonstrate that it meets the Taxonomy criteria – even if it the performance is better than average or improving over time – it is not sustainable. It is simply causing less harm. Claiming that this is green, even if qualified as "light green", is fundamentally misleading.

The fact that a relatively small proportion of the global economy is Taxonomy-aligned does not invalidate this approach. It demonstrates that globally, the pace and scale of the transition is inadequate.

3.2 FINANCIAL STABILITY RISK

84. Climate change will impact financial stability through two main channels: physical risks, related to damages from climate-related events, and transition risks, related to the effect of mitigation strategies, especially if these are adopted late and abruptly. In addition, second-order effects (for instance the impact of climate change on real estate prices) can further weaken the whole financial system. What are in your view the most important channels through which climate change will affect your industry? Please provide links to quantitative analysis when available.

- Physical risks, please specify if necessary [BOX max. 2000 characters]

- Transition risks, please specify if necessary [BOX max. 2000 characters]
- Second-order effects, please specify if necessary [BOX max. 2000 characters]
- Other, please specify [BOX max. 2000 characters]

As the realities of climate change become increasingly apparent, it is inevitable that governments will be forced to act more decisively than they have so far. Financial markets do not adequately price-in the near-term policy response to climate change.

The questions for risk forecasting are when this response will come, what policies will be used, and where will the impact be felt. PRI's "inevitable policy response" to climate change programme presents a forecast policy scenario, as well as equity impact analysis, setting out the significant risk of value loss across sub-sector and sector.

It finds:
- The 100 worst performing companies in the MSCI ACWI lose -43 percent of their current value, equivalent to $1.4tn.
- World's largest listed coal companies could halve in value (-44 percent)
- The ten largest companies in the integrated oil & gas exploration & production sector by market cap lose nearly a third (31 percent) of current value, or $0.5tn
- Electric utilities with the strongest strategy for renewables could see valuation double (104 percent), while laggards could see valuations fall by two-thirds (-66 percent)
- Miners producing minerals critical for the transition see a 54 percent upside, while those with the smallest share of "green minerals" see valuations halve (-49 percent).

The full findings are set out here: https://www.unpri.org/inevitable-policy-response/forecast-policy-scenario-equity-markets-impacts/5191.article.

85. What key actions taken in your industry do you consider to be relevant and impactful to enhance the management of climate and environment related risks?

Please identify a maximum of three actions taken in your industry [BOX max. 2000 characters]

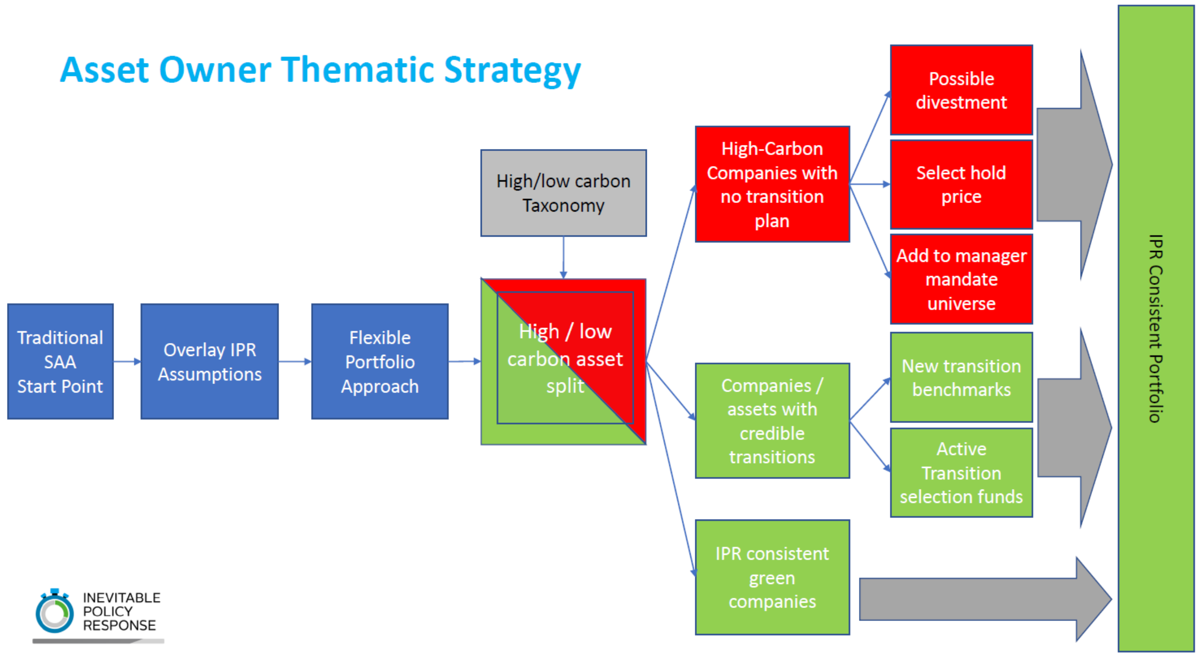
The PRI recommends the following actions for institutional investors to manage climate and environment related risks. These themes are addressed throughout the consultation, and can be categorised as policy engagement, company engagement and capital allocation.

Undertake policy engagement to decarbonise the economy - Align policy engagement and investment objectives; work to policymakers' timetables; leverage arguments based on technical expertise; engage at all levels of the policy process, as well as through the media, as far as possible; work together and speak with a coherent voice, especially where there is consensus; better understand the relevant dynamics of policy decision-making across committees and groups; and be clear about who investors represent and how policies impact the investor base.

Engage with companies - Focus on delivering outcomes on systemic issues and collaborate with diverse and sometimes competing organisations to work together effectively.

Reallocate capital to low carbon assets - Redesign of external mandates; reallocate thematically; set new benchmarks; limit use of tracking error; develop new financial products and introduce new screens (e.g. exclusions).

The PRI recommends the following actions for portfolio action:



86. Following the financial crisis, the EU has developed several macroprudential instruments, in particular for the banking sector (CRR/CRDIV), which aim to address systemic risk in the financial system. Do you consider the current macroprudential policy toolbox for the EU financial sector sufficient to identify and address potential systemic financial stability risks related to climate change? Please express your view by using a scale of 1 (highly inadequate) to 5 (fully sufficient).

- Please express your view by using a scale of 1 (highly inadequate) to 5 (fully sufficient).
- For scores of 1-2, what solution would you propose? Please list a maximum of three. [BOX max 2000 characters]

No PRI response

87. Beyond prudential regulation, do you consider that the EU should take further action to mobilise insurance companies to finance the transition and manage climate and environmental risks?

- <u>Yes</u>
- No
- Do not know.

- If yes, please specify which actions would be relevant. [BOX max. 2000 characters]

The same actions recommended throughout the response regarding clarification of impact duties and disclosure obligations, stewardship.

88. Do you consider that there is a need to incorporate ESG risks into prudential regulation in a more effective and faster manner, while ensuring a level playing field?

 Yes/No/Do not know.
 If yes, is there any category of assets that could warrant a more risk-sensitive treatment? Are there any other prudential measures that could help promoting in a prudentially sound way the role of the EU banking sector in funding the transition to a more sustainable economy? [box max. 2000 characters]

No PRI Response

89. Beyond prudential regulation, do you consider that the EU should take further action to mobilise banks to finance the transition and manage climate-related and environmental risks?

 <u>Yes one or both</u>
 No.
 Do not know.

Please specify which action would be relevant [BOX max. 2000 characters]

PRI does not consider banking issues in detail but recognises that Europe's economy is heavily reliant on bank lending and as such, banks should also be considered in strategies to finance the transition and manage environmental risk.

90. Beyond the possible general measures referred to in section 1.6, would more specific actions related to banks' governance foster the integration, the measurement and mitigation of sustainability risks and impacts into banks' activities?

No PRI response.

91. Do you see merits in adapting rules on fiduciary duties, best interests of investors/the prudent person rule, risk management and internal structures and processes in sectorial rules to directly require them to consider and integrate adverse impacts of investment decisions on sustainability (negative externalities)?

- <u>Yes</u>
- No
- Do not know

If yes, what solution would you propose? [BOX max. 2000 characters]

This response draws from preliminary analysis as part of the PRI, UNEP FI and The Generation Foundation project *A Legal Framework for Impact,* an ongoing programme to understand and analyse how investors can manage fiduciary duties and sustainability impact, and how to resolve situations where they may be in conflict. At this stage, we have identified some potential challenges within the framework. Formal recommendations from this programme will be shared in late 2020.

The scope of this question could include firms regulated under different regimes, including IORP II, PEPP, Solvency II, MifID II, UCITS and AIFMD. Please also see the PRI's response to the draft amendments to the delegated acts underpinning several of these frameworks.

Under current EU law, different types of investors may be permitted, restricted from or mandated to consider impact.

- Occupational Pensions regulation can be interpreted as permissive. Article19.1(b) of Directive (EU) 2016/2341 permits IORPs to consider the potential long-term effect of investment decisions on ESG factors.
- Insurance firms, under current proposals, will be required to consider impact and respond to client preferences. The new Article 275(a) in Delegated Regulation (EU) 2015/35 requires insurers to consider the potential long-term impact of their investment strategy and decisions on sustainability factors and respond to customer preferences.
- UCITS management companies have some adverse impact related obligations, but conflicts remain in the framework. Proposed amendments to Commission Directive 2010/43/EU will require UCITS management companies to incorporate adverse impacts into due diligence processes where they consider adverse impacts under their SFDR obligations. However, there is no clarification of the relationship between the need to pursue impact and the duty to act in the best interests of the UCITS, which in the absence of an investment policy with specific sustainability objectives will likely be understood as financial best interest. This could be interpreted as preventing the UCITS from excluding harmful but profitable investments, or from incurring costs while pursuing stewardship for the purposes of mitigating adverse impact without immediate expectation of financial return.

Even where impact is mandated, practical challenges will remain without clear guidance on resolving potential conflicts between sustainability impact and financial return.

Clarifying duties is part of the solution. However, we recommend the EU consider how the overall policy framework can be designed in a way that ensures that investors systematically assess, measure and manage the sustainability impacts (positive and negative) of their investment decisions.

92. Should the EU explore options to improve ESG integration and reporting beyond what is currently required by the regulatory framework for pension providers?

- <u>Yes</u>
- No
- Do not know.

If yes, please specify what actions would be relevant in your view. [BOX max. 2000 characters]

Pension funds, in terms of weight of capital and influence, have the potential to substantially contribute to the sustainability goals the EU and its member states have set themselves. Pension funds are often focused on the long-term, with new members likely to be drawing their pensions well into the second half of this century.

As with Q91, clarifying duties is part of the solution. PEPP and IORP II have different levels of requirement. IORPs are permitted to consider impact, whereas PEPP providers are required to consider impact. In addition, we recommend the EU consider how the overall policy framework can be designed in a way that ensures that pension funds systematically assess, measure and manage the sustainability impacts (positive and negative) of their investment decisions, and respond to the preferences of beneficiaries. Clear guidance is needed on resolving potential conflicts between sustainability impact and financial return.

93. More generally, how can pension providers contribute to the achievement of the EU's climate and environmental goals in a more proactive way, also in the interest of their own sustained long-term performance? How can the EU facilitate the participation of pension providers to such transition? [BOX max. 2000 characters]

Broadly speaking, pension providers have three levers of influence – providers can allocate capital; providers can engage companies; and providers can engage policy makers.

<u>Capital allocation</u>
Providers can:

- Engage savers on net-zero aligned products.
- Allocate to net-zero aligned benchmarks.
- Consider increase in active allocation.
- Engage with asset managers on net-zero product developments.
- Engage with companies on net-zero transition plans.
- Engage on corporate debt
- Allocate to new green bond indices.
- Invest in transition bonds.
- Identify climate sovereign risks.
- Engage with ratings agencies on sustainability-related credit risk
- Allocate to green infrastructure
- Bring green private equity companies to market
- Invest in forestry and nature based assets.

<u>Company Engagement</u>

- Purposeful, and if necessary, forceful company engagement to align company business models with environmental goals.
- Vote against company directors that do not take action on climate change.

- Allocate capital to asset managers with high performing stewardship teams.

Policy Engagement

- Engage financial regulators on sustainable finance regulation.
- Engage policymakers on delivery against sustainability goals.
- Provide technical expertise to policymakers in support of policy change.

94. In view of the planned review of the IORP II Directive in 2023, should the EU further improve the integration of members' and beneficiaries' ESG preferences in the investment strategies and the management and governance of IORPs?

- Yes
- No
- Do not know

If yes, how could this be achieved, taking into account that IORPs are collective schemes whose members may have different views on ESG integration? [BOX max. 2000 characters]

First and foremost, IORPs must recognise that many sustainability issues will be financially material. Taking action on climate change, for example, does not require them to consult their beneficiaries. This is not yet happening at the necessary pace and scale. In their 2019 stress tests[12], EIOPA found that only 19% of IORPs assess the impact of ESG factors on investment risks and returns and equity investments show high carbon exposure relative to EU economy.

To understand the preferences of scheme members, pension providers can rely on survey data, integrate members into governance processes (e.g. Member nominated trustees or engagement committees) or make informed judgements based on reliable assumptions (for example, it is reasonable to assume that scheme members would prefer not to). Transparency around the sustainability impacts of existing portfolios is also important to enable dialogue with scheme members.

3.3 CREDIT RATING AGENCIES

95. How would you assess the transparency of the integration of ESG factors into credit ratings by CRAs? Please express your view by using a scale of 1 (not transparent at all) to 5 (very transparent).

Please express your view by using a scale of 1 (not transparent at all) to 5 (very transparent). If necessary, please explain the reasons for your answer. [BOX max. 2000 characters]

PRI response - 3

[12] https://www.eiopa.europa.eu/sites/default/files/financial_stability/occupational_pensions_stress_test/2019/eiopa_2019-iorp-stress-test-report.pdf

The vote of 3 reflects the large disparity between the progress that large CRAs and smaller credit rating agencies have made over the past few years. Fitch Ratings, Moody's Investor Service and S&P Global Ratings have increased significantly the transparency of their methodologies to describe how they incorporate ESG factors; have developed in-house materiality maps; have improved communication in the commentaries accompanying credit rating opinions and increased outreach on ESG topics as documented in the PRI's trilogy: Shifting perceptions: ESG, credit risk and ratings (in particular report nr 3, pages 9-10). The smaller credit rating agencies have lagged behind, partly due to lack of resources.

96. How would you assess the effectiveness of the integration of ESG factors into credit ratings by CRAs? Please express your view by using a scale of 1 (very ineffective) to 5 (very effective).

Please express your view by using a scale of 1 (very ineffective) to 5 (very effective).
If necessary, please explain the reasons for your answer. [BOX max. 2000 characters]

PRI Response - 3

More than effectiveness it would be better to speak of how well are CRAs assessing and incorporating the materiality of ESG factors in their credit ratings. Again, here there is a large disparity between the advancement by large and small CRAs. The large ones have made significant progress in educating and equipping analysts to better incorporate ESG factors in credit rating opinions; they have expanded analytical tools as well as sectoral and thematic research (which sends long-term signals). It is taking time but better awareness, understanding and measurement of ESG factors are trickling through credit rating opinions.

However, the timeframe of the risk assessment remains problematic for many ESG factors (several of which are linked to long-erm trends) to become actual drivers of rating action (which are typically linked to 3-5 year ahead forecasts). Moreover, regulatory changes (particularly linked to climate change) that are becoming increasing likely are incorporated only when they crystallise.

To address the time-horizon challenge scenario analysis and stress testing can make credit risk analysis more forward looking –but by considering how an issuing entity might perform in response to a range of hypothetical outcomes. It can help to assess the awareness of risks by bond issuers and their preparedness to address them. However, scenario analysis and stress testing have their limitations when it comes to ascertaining plausibility (as this depends on how realistic the underlying assumptions are), as well as comparability and how many scenarios to consider overall. Here, it would be important to get the industry to start using a 'common' set of scenarios (for example a 2° or a 1.5° scenario; or the PRI's Inevitable Policy Response).

97. Beyond the guidelines, in your opinion, should the EU take further actions in this area?

- Yes
- No
- Do not know

If yes, please specify what kind of action you consider would address the identified problems. In particular should the EU consider regulatory intervention? [BOX max. 2000 characters]

The current regulation (EC) No 1060/2009 on CRAs already states that “Where appropriate, rating methodologies should take into account financial risks deriving from environmental hazards”. This should also reflect social risks.

3.4 NATURAL CAPITAL ACCOUNTING OR “ENVIRONMENTAL FOOTPRINT”

98. Are there any specific existing initiatives (e.g. private, public or other) you suggest the Commission should consider when supporting more businesses and other stakeholders in implementing standardised natural capital accounting/environmental footprinting practices within the EU and internationally?

- <u>Yes</u>
- No
- Do not know

If yes, please list a maximum of three relevant initiatives. [BOX max. 2000 characters].

Standardised natural capital accounting practices should be considered within the EU’s overall framework for corporate and investor disclosure, not as a separate initiative. As such, the three initiatives we consider relevant are EU regulations:

i. Non-Financial Reporting Directive
ii. Disclosures Regulation
iii. Taxonomy Regulation.

3.5 IMPROVING RESILIENCE TO ADVERSE CLIMATE AND ENVIRONMENTAL IMPACTS

99. In your opinion, should the European Commission take action to enhance the availability, usability and comparability of climate-related loss and physical risk data across the EU?

- <u>Yes</u>
- No
- Do not know.

If yes, please select all that apply:

- Loss data, please explain why [BOX max. 2000 characters]
- Physical risk data, please explain why [BOX max. 2000 characters]

100. Is there a role for the EU to promote more equal access to climate-related financial risk management mechanisms for businesses and citizens across the EU?

- Yes
- No
- Do not know.

If yes, please indicate the degree to which you believe the following actions could be helpful, using a scale of 1 (not helpful at all) to 5 (very helpful) and substantiate your reasoning:

- Financial support to the development of more accurate climate physical risk models. [BOX max. 2000 characters]
- Raise awareness about climate physical risk. [BOX max. 2000 characters].
- Promote ex-ante “build back better” requirements to improve future resilience of the affected regions and or/sectors after a natural catastrophe. [BOX max. 2000 characters].
- Facilitate public-private partnerships to expand affordable and comprehensive insurance coverage. [BOX max. 2000 characters].
- Reform EU post-disaster financial support. [BOX max. 2000 characters].
- Support the development of alternative financial products (e.g. catastrophe bonds) offering protection/hedging against financial losses stemming from climate- or environment-related events. [BOX max. 2000 characters]
- Advise Member States on their national natural disaster insurance and post disaster compensation and reconstruction frameworks. [BOX max. 2000 characters].
- Regulate by setting minimum performance features for national climate-related disaster financial management schemes. [BOX max. 2000 characters].
- Create a European climate-related disaster risk transfer mechanism. [BOX max. 2000 characters].
- Other, please specify. [BOX max. 2000 characters].

101. Specifically with regards to the insurability of climate-related risks, do you see a role for the EU in this area?

- Yes
- No
- Do not know.

No PRI response.

If yes, which actions you would consider to be useful? In particular, is there scope for EU action to improve the offer of products and services for climate-related disaster risk reduction, enhance insurers’ potential to promote increased resilience of their policyholders beyond a mere compensatory role?

- Yes
- No
- Do not know.

If yes, please explain which actions and the expected impact (high, medium, low). [BOX max. 2000 characters]

If no, please explain. [BOX max. 2000 characters]

102. In your view, should investors and / or credit institutions, when they provide financing, be required to carry out an assessment of the potential long-term environmental and climate risks on the project, economic activity, or other assets?

- <u>Yes</u>
- No
- Do not know.

If yes, what action should the EU take? Please list a maximum of three actions. [BOX max. 2000 characters]

Under EU law, investors are already required to consider material climate risks when making investment decisions. Strengthening corporate reporting, with a particular focus on integration of the recommendations of the Taskforce on Climate-Related Financial Disclosure, should be a focus. It is recommended that this is reflected in the Disclosure Regulation for Financial Market Participants.