



U.S. POLICY BRIEFING

CONSIDERATIONS FOR U.S. REGULATORS TO ENHANCE INVESTORS' ABILITIES TO IDENTIFY, ASSESS AND TAKE ACTION ON ESG-RELATED RISKS AND OPPORTUNITIES

March 2021



THE PRINCIPLES FOR RESPONSIBLE INVESTMENT

The United Nations-backed Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI has over 3500 signatories (pension funds, insurers, investment managers and service providers) globally with approximately U.S. \$100 trillion in assets under management.¹

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 briefing represents the views of the PRI Association and not necessarily the views of its individual members.

More information: www.unpri.org

ABOUT THIS BRIEFING

This briefing outlines several broad policy objectives and identifies actions federal financial regulators and lawmakers in the United States can take to revise the U.S. regulatory regime to better promote the integration of environmental, social and governance (ESG) factors into investment practice and decision-making. It is largely focused on actions at the Securities and Exchange Commission (SEC), given that much of the corporate accountability regime in the United States centers on the rules and operations of the SEC. In addition, it identifies specific actions that can be taken by the United States Congress, U.S. Department of Labor (DOL), Public Company Accounting Oversight Board (PCAOB), and Financial Industry Regulatory Association (FINRA) to ensure that private market actors better identify, assess and address the risks and opportunities posed by global challenges including climate change, human rights violations, human capital management and tax avoidance.

For more information, contact policy@unpri.org.

¹ See PRI signatories, available at: <https://www.unpri.org/signatories/signatory-resources/signatory-directory>.

INTRODUCTION

Responsibly addressing the coronavirus pandemic, climate change, human rights, human capital management and subsequent economic loss are challenges not unique to the United States, and governments alone cannot overcome them. Companies, brokers, investors, insurers and other capital markets participants have key roles to play in responsibly directing capital and investments toward a more just and sustainable economy.

Under President Trump, the United States quickly and publicly withdrew from the then-new Paris Climate Agreement. While only one action, withdrawing from a consequential and otherwise universally accepted climate agreement serves as a proxy for the past administration's general views and actions around climate change and other ESG issues. While the rest of the world moved forward, financial regulators led by political appointees of the previous administration took a number of actions intended to impede the consideration of ESG factors in investment decisions and stall broader global efforts to address climate change.

In his first week in office, President Biden issued several executive orders that put climate change, pandemic protection, inequality and racial justice at the center of his economic and policy agenda. It is clear that a focus on ESG factors in policymaking will continue into the future. The PRI believes these actions will help to accelerate a lasting and sustainable economic recovery and contribute to progress tackling climate change and unravelling the social and racial inequities that continuously prevent economic success for so many and stymie long-term economic growth.

There are several broad policy objectives and actions federal financial regulators, particularly the SEC and DOL, and lawmakers can take to promote the integration of ESG factors and ensure investors can better identify, assess and address ESG-related risks and opportunities. Modernizing existing regulations to make clear that ESG factors can be material and have a financial impact on a company or investment is a first step, among many, that the Biden Administration must take to get the U.S. on track. Fully integrating ESG considerations through policy action will help to better measure and understand climate and other risks across the financial system and promote long-term financial and economic stability and growth.

The PRI supports a renewed, comprehensive effort from the United States government to update the regulatory system to facilitate better outcomes for investors committed to responsible investment. The Biden Administration has already begun to move in this direction. This month, the DOL announced it will not enforce two recently finalized rules, *Financial Factors in Selecting Plan Investments* and *Fiduciary Duties Regarding Proxy Voting and Shareholder Rights*, that discourage ESG investment and engagement on ESG issues in the proxy voting process.² At the SEC, Acting Chair Allison Herren Lee recently announced the agency is requesting public comments on climate change disclosure.³

² Department of Labor, U.S. Department of Labor Statement Regarding Enforcement of its Final Rules on ESG Investments and Proxy Voting by Employee Benefit Plans (March 10, 2021) available at: <https://www.dol.gov/sites/dolgov/files/ebsa/laws-and-regulations/laws/erisa/statement-on-enforcement-of-final-rules-on-esg-investments-and-proxy-voting.pdf>.

³ Securities and Exchange Commission, Public Statement by Acting Chair Allison Herren Lee, *Public Input Welcomed on Climate Change Disclosures* (March 15, 2021) available at: <https://www.sec.gov/news/public-statement/lee-climate-change-disclosures>.

The recommendations that follow outline broad policy objectives and identify actions federal financial regulators and lawmakers in the United States can take to better promote the integration of ESG factors into investment practice and decision-making.

CORPORATE ESG DISCLOSURE

Corporate ESG disclosure is critical to the ability of investors to fully consider material ESG risks and opportunities and increasingly important to understanding corporate and investor activity in meeting sustainability goals. PRI signatories continually report that the lack of consistency, comparability and quality of corporate disclosure on ESG matters is a substantial barrier to their responsible investment practice.

The PRI is working with its global network of signatories to advocate for the inclusion of material sustainability information alongside other financial data in corporate disclosure. Investors need a system of globally comparable sustainability information with an “end-to-end” perspective, designed to fulfill the data needs of users and preparers of sustainability information. This information can then be used systematically to support investment decision-making.

Principally, sustainability reporting should:

1. Provide current and forward-looking information to assess the full range of sustainability risks and opportunities.
2. Enable investors and other stakeholders to consistently assess and compare a company’s sustainability performance and alignment with long-term sustainability goals and thresholds.

In order to deliver on the above, the PRI believes the current corporate sustainability reporting system needs to evolve into a future state where:

- Reporting provides comparable and consistent indicators and metrics not only on company level, but also at the activity and asset level.
- Corporate sustainability disclosure is mandatory and comparable across markets, sectors and activities.
- Corporate sustainability reporting frameworks are implemented with an appropriate long-term governance structure with third-party verification.

The PRI encourages efforts by public and private initiatives toward alignment and consolidation of corporate ESG disclosure frameworks. A set of ESG disclosure standards, widely supported and endorsed by public and private stakeholders, would be a significant step toward achieving this.⁴

Several non-governmental organizations have spent years developing, and now are working to harmonize and implement, ESG-related disclosure regimes. U.S. financial regulators should consider utilizing these foundational projects and building upon these efforts, to establish consistent, comparable, reliable reporting of ESG-related disclosures. In particular, the SEC should consider adopting disclosure requirements consistent with the Financial Stability Board’s Task Force on

⁴ PRI’s position on sustainability reporting, from the questionnaire response to IFRS Foundation consultation paper on sustainability reporting (December 2020) available at: https://www.unpri.org/Uploads/x/t/o/priresponseitoifrsfoundationconsultationonsustainabilityreporting_143880.pdf.

Climate-Related Financial Disclosures (TCFD),⁵ the recommendations in the U.S. Commodity Futures Trading Commission (CFTC) report,⁶ and to the extent possible, the European Commission's Non-Financial Reporting Directive (NFRD).⁷

In revising SEC filings for corporate issuers to include ESG information, the PRI recommends the Commission create a set of relevant national disclosure requirements that are also aligned and comply with existing international frameworks. This must be done while abiding by the Administrative Procedures Act requirements, including the mandate to fully consider specific concerns raised by interested parties through the rulemaking process. Standardized, mandatory disclosure requirements that also are bound by harmonized, and widely accepted, international frameworks reduces the challenges of compliance across multiple jurisdictions and facilitates the efforts of global investors to integrate ESG data into their investment practices.

The existing disclosure frameworks continue to evolve as more data is gathered and industry gains a better understanding of the most effective, comprehensive and practical disclosure metrics. At a high-level, company disclosure should include:

- Data relating to physical and non-physical assets (such as patents) tied to company ownership. This is particularly relevant for financial risks and opportunities associated with transitions.
- Data relating to the ESG risks and opportunities associated with production of specific goods and services.
- ESG metrics that are financially material to the organization, including both past performance as well as forward-looking statements and how these risks and opportunities are managed.
- Disclosure of ESG issues that are financially material to the organization's operating sector.
- Consistent data that serves as the basis from which sustainability performance of a company's assets and activities can be assessed by investors against long-term sustainability goals or targets.⁸

In 2017, the PRI and Baker McKenzie reviewed how the TCFD recommendations could be integrated into existing corporate disclosure regulation in six countries, including the U.S.⁹ The U.S. report notes that "there is no explicit requirement for public companies to disclose impacts related to climate change in financial filings" in the United States, but the SEC's 2010 climate guidance states the Commission's views on disclosure of climate impacts that may be material for issuers under existing

5 TCFD Recommendations, available at: <https://www.fsb-tcfcd.org/recommendations/>.

6 U.S. financial regulators could use climate related market risk metrics from the CFTC report, Managing Climate Risk in the U.S. Financial System, Report of the Climate-Related Market Risk Subcommittee, Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission (September 2020) available at: <https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf>. In particular, Chapter 4, "Existing Authorities and Recommendations for Financial Regulators," identifies actions regulators could already take under their existing mandates (including climate-related stress-testing) and Chapter 7, "A Closer Look at Climate Risk Disclosure," makes recommendations for the SEC to require TCFD-aligned disclosure.

7 European Commission Non-financial reporting directive (NFRD) available at: https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/non-financial-reporting_en.

8 From PRI, *Driving Meaningful Data – financial materiality, sustainability performance and sustainability outcomes report* (September 2020) available at: <https://www.unpri.org/download?ac=11641>.

9 PRI and Baker McKenzie, *Recommendations of the Task Force on Climate-related Financial Disclosures – review for local relevance, United States* (2017) available at: <https://www.unpri.org/climate-change/tcfcd-recommendations-country-reviews/278.article>.

SEC regulations.¹⁰ The Guidance indicates four Items in Regulation S-K that could be used to disclose climate-related risk for issuers on an annual basis in an existing and standardized format, which could also be applied for other relevant ESG factors.

Regulation S-K Item	Potential for disclosing climate-related risk
Item 101	This Item requires that a company must disclose any material expenditures associated with environmental controls, including costs of complying with new environmental legislation or regulations.
Item 103	This Item requires disclosure of material pending legal proceedings to which the registrant or its subsidiaries is a party, due to the immediate and future costs of litigation.
Item 303	This Item governs the more subjective area of Management Discussion and Analysis ("MD&A"). This Item requires disclosure of major trends, events, and uncertainties that could be reasonably expected to materially affect business operations. This requirement contained two separate inquiries: (1) whether an uncertainty is reasonably likely to occur; and (2) whether management can determine that an uncertainty's occurrence is not reasonably likely to have a material effect on the company. Disclosure is required unless a company is able to conclude either that it is not reasonably likely that the trend, uncertainty or other event will occur or come to fruition, or that a material effect on the company's liquidity, capital resources or results of operations is not reasonably likely to occur. ¹²
Item 503	This Item requires disclosure of specific, significant factors that would make investment in a company risky or speculative. It contains regular factors included in many companies' risk management strategies: physical, financial, and reputational risks to name a few.

Source: PRI Baker McKenzie U.S. review (2017)

Although the 2010 Guidance provided information for issuers on potential climate impact disclosures through Regulation S-K, it did not include how issuers should discuss their disclosures of climate-related risk. This has led to companies using various voluntary frameworks to disclose climate data, making it difficult for investors to review data in a consistent format. In order to provide clarity and consistency for investors, the Acting Chair recently announced the SEC's intent to start a climate disclosure process through requesting public comments on climate change disclosure,¹¹ revisiting the 2010 Guidance,¹² as well as reviewing previous Commission guidance and regulation in order to create an effective ESG disclosure system for U.S. companies.¹³

10 Securities and Exchange Commission, *Commission Guidance Regarding Disclosure Related to Climate Change*, Release Nos. 33-9106, 34-61469 (Feb. 8, 2010) available at: <https://www.sec.gov/rules/interp/2010/33-9106.pdf>.

11 Securities and Exchange Commission, Public Statement by Acting Chair Allison Herren Lee, *Public Input Welcomed on Climate Change Disclosures* (March 15, 2021) available at: <https://www.sec.gov/news/public-statement/lee-climate-change-disclosures>.

12 Securities and Exchange Commission, Public Statement by Acting Chair Allison Herren Lee, *Statement on the Review of Climate-Related Disclosure* (February 24, 2021) available at: <https://www.sec.gov/news/public-statement/lee-statement-review-climate-related-disclosure>.

13 Securities and Exchange Commission, Public Statement by John Coates, Acting Director, Division of Corporation Finance, *ESG Disclosure – Keeping Pace with Developments Affecting Investors, Public Companies and the Capital Markets* (March 11, 2021) available at: <https://www.sec.gov/news/public-statement/coates-esg-disclosure-keeping-pace-031121>; see also SEC, Speech by Acting Chair Allison Herren Lee, *A Climate for Change: Meeting Investor Demand for Climate and ESG Information at the SEC* (March 15, 2021) available at: <https://www.sec.gov/news/speech/lee-climate-change>.

CORPORATE ACCOUNTABILITY

The financial regulatory regime in the U.S. requires detailed disclosures and shareholder rights for companies that make “registered” offerings of securities or that otherwise are obligated to meet ongoing reporting requirements. While the registration requirement for “public” offerings of securities initially covered the vast majority of capital raised, significant expansions of exemptions have now rendered approximately 70 percent of capital raising exempt from these requirements. For example, from 2000 to 2017, the number of public companies shrank from approximately 6900 to 4300, while the number of private companies grew from about 1600 to 7600.¹⁴

However, as described above, information and engagement rights are essential preconditions for restoring corporate accountability across an array of issues, and ESG-related factors are no exception. The SEC should consider revising its rules to ensure that all large companies, offerings and funds make essential disclosures, including relevant ESG-related information. This could include, for example, ensuring that companies become public reporting companies if they hit triggers related to revenues, market capitalization, number of beneficial owners, have material contracts with the government, or have a large number of employees.

DEBT SECURITIES

Another area of focus for the SEC should be on debt securities. In the midst of the coronavirus crisis, companies and individuals took on record amounts of debt. Nearly all of the corporate debt sold during this crisis, much like during the runup to the 2008-2009 crisis, has been exempted from detailed disclosure and rights obligations pursuant to Rule 144A. The SEC should consider requiring debt offered through Rule 144A to include ESG-related disclosures that are consistent with those required of companies, above, including details regarding physical and transition risks of climate change.

¹⁴ Bloomberg, *Where have all the US public companies gone?* (April 2018) available at: <https://www.bloomberg.com/opinion/articles/2018-04-09/where-have-all-the-u-s-public-companies-gone>.

INVESTOR DISCLOSURE REGULATIONS

For investment companies, like mutual funds, the accuracy and comparability of disclosure depends on the progress and success of disclosure requirements for publicly traded companies. In the near-term, the SEC should require investment advisers to adopt sustainable investment policies, disclose them to investors and obtain independent, third-party verification of compliance.

ESG disclosure requirements for investment companies should be consistent and align with corporate disclosures to reduce implementation costs and improve the ability to collect and aggregate data. For example, the SEC could adopt rules to require investment companies to make detailed disclosures regarding their collective climate impacts across the companies in their portfolios.

The SEC could leverage the work of the Partnership for Carbon Accounting Financials (PCAF) for methodologies and approaches to calculating "financed emissions" in an investment company's portfolio.¹⁵ Alignment will be most necessary for asset owners at the end of the investment chain.¹⁶ Several large, U.S.-based financial institutions, including Bank of America, Citibank and Morgan Stanley have recently announced support for the PCAF methodology, which may accelerate its uptake within the U.S.¹⁷

In the future, to provide the best available climate data for investors, the SEC could mandate investment companies disclose on climate-related risks and opportunities consistent with the TCFD recommendations, including forward-looking metrics. Forward-looking metrics should include physical and transition risks and opportunities in the portfolio, portfolio alignment with climate goals and contribution towards reducing climate-related risks in the market.¹⁸

Indeed, as it begins to require disclosure of material ESG factors, the SEC should clarify that materiality is to be defined from the point of view of an investor in the market, and with an awareness of systemic risk. Due to the rise of institutional investment over the last several decades, the typical investor in the U.S. market is broadly invested across the economy. Actions by individual companies in such an investor's portfolio may impose costs and risks on other companies held in the same portfolio. Thus, individual issuers should be required to report not only on the risks posed to their businesses by potentially material ESG factors such as climate change, but also on their own impact on the issue. In this way, the traditional SEC mandate to ensure full disclosure of factors relevant to a prudent investor's decision-making can be upheld in the current investment landscape.

15 Partnership for Carbon Accounting Financials (PCAF), available at: <https://carbonaccountingfinancials.com/>.

16 The PRI, *Discussion Paper Forward Looking Climate Metrics* (January 2021) available at: https://unpri.org/Uploads/g/w/g/pridiscussionpaperontcfdforwardlookingmetricsconsultationjan2021_953258.pdf.

17 Partnerships for Carbon Accounting Financials (PCAF), *Financial Institutions Taking Action*, available at: <https://carbonaccountingfinancials.com/financial-institutions-taking-action#overview-of-institutions>.

18 The PRI, *Discussion Paper Forward Looking Climate Metrics* (January 2021) available at: https://unpri.org/Uploads/g/w/g/pridiscussionpaperontcfdforwardlookingmetricsconsultationjan2021_953258.pdf.

FIDUCIARY DUTY

It is unlikely that enhanced ESG-related disclosures will impact corporate behavior unless investors review, assess and act upon them. In 2016, the PRI and United Nations Environment Programme Finance Initiative (UNEP FI) began a four-year project focused on reviewing and clarifying the fiduciary duties of investors. In our *Fiduciary Duty in the 21st Century Final Report*,¹⁹ we found that the fiduciary duties of investors require them to:

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

In 2018, the PRI introduced minimum requirements for signatories including an investment policy that covers the investor's responsible investment approach, which must account for more than 50% of assets under management, as well as senior-level oversight and agreed implementation responsibilities.²⁰

SEC

The SEC should consider requiring investment advisers to adopt policies and procedures to identify, assess and address ESG-related risks and opportunities, and establish a clear governance structure to ensure compliance with those policies and procedures. Notably, these policies should not seek to supplant the judgment of investment fiduciaries, but rather ensure the consideration of relevant ESG factors as part of their fiduciary obligation. The SEC could initially offer staff guidance to clarify that ESG factors are material considerations for investment advisers and encourage them to integrate material ESG factors into their proxy voting practices. Further, the SEC could issue rules that require investment advisers to establish and disclose sustainable investment policies that clearly define how the adviser will consider and act upon material environmental, social and governance risks and opportunities associated with the portfolios the adviser manages. These rules could also require that advisers obtain independent, third-party verification of adherence to the sustainable investment policies they establish.

The SEC should also consider adopting rules to ensure that investment fiduciaries, including those for passive investment vehicles, consider all relevant issues and participate in proxy voting when matters

¹⁹ The PRI, *Fiduciary Duty in the 21st Century Final Report* (2019) available at: <https://www.unpri.org/fiduciary-duty/fiduciary-duty-in-the-21st-century-final-report/4998.article>.

²⁰ The PRI, *Minimum Requirements for Investor Membership* (2018) available at: <https://www.unpri.org/reporting-and-assessment/minimum-requirements-for-investor-membership/315.article>. At time of publication, the PRI is reviewing the minimum requirements, with the aim of introducing revised requirements in the 2022 Reporting Framework.

are brought up for a shareholder vote. This obligation to consider issues and vote would be similar to guidance previously provided by the Department of Labor regarding ERISA Plan fiduciaries.²¹

DEPARTMENT OF LABOR

The DOL oversees the administration of more than \$7 trillion in retirement funds subject to the Employee Retirement Income Security Act of 1974. The Biden Administration originally listed the recent DOL rule, *Financial Factors in Selecting Plan Investments*, for review under the Executive Order on Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis.²² Most recently, the DOL announced it will not enforce *Financial Factors in Selecting Plan Investments* or *Fiduciary Duties Regarding Proxy Voting and Shareholder Rights* until further guidance is published. The Department intends to revisit both rules.²³

It is imperative to ensure that retirement plan fiduciaries are not just able, but directed, to consider relevant ESG-factors, as well as vote and otherwise exercise rights as shareholders with respect to ESG-related issues. Similarly, the DOL should consider requiring ERISA plan fiduciaries to adopt, implement and disclose sustainable investment policies and procedures to ensure the consideration of ESG factors, which should, to the extent possible, seek to align requirements to those prescribed by the SEC to investment advisers.

21 Letter from Alan D. Lebowitz, Deputy Assistant Secretary to Mr. Helmuth Fandl, Chairman of the Retirement Board, Avon Products, Inc. (February 23, 1988), 1988 ERISA LEXIS 19, *5-6.

22 White House, *Fact Sheet: List of Agency Actions for Review* (January 20, 2021) available at: <https://www.whitehouse.gov/briefing-room/statements-releases/2021/01/20/fact-sheet-list-of-agency-actions-for-review/>.

23 Department of Labor, *U.S. Department of Labor Statement Regarding Enforcement of its Final Rules on ESG Investments and Proxy Voting by Employee Benefit Plans* (March 10, 2021) available at: <https://www.dol.gov/sites/dolgov/files/ebsa/laws-and-regulations/laws/erisa/statement-on-enforcement-of-final-rules-on-esg-investments-and-proxy-voting.pdf>.

SHAREHOLDER RIGHTS

Corporate accountability is not simply about providing investors and the public more comparable information, but it is also about investors acting based on that information. By engaging in the proxy voting process, investors are able to fulfill their obligations as part of the value creation process over the short, medium and long terms.²⁴ Investors should be able to submit, consider and vote on shareholder proposals. Further, investors should not be unduly burdened by unnecessary processes or limitations on their abilities to obtain or rely upon expert assistance in areas relevant to the exercise of their fiduciary obligations. Unfortunately, recent actions by regulators have unnecessarily impaired investors' abilities to act in their clients' best interest, including:

- changes to the Rule 14a-8 on shareholder proposals,²⁵
- changes to the Rule 14a-1(l), 14a-2(b)(1) and 14a-2(b)(3) and 14a-9 on proxy voting advice, and
- analysis of "ordinary business" and "no-action" determinations.

The SEC's rules around the proxy process were initially established to allow for active shareholder participation at corporations' annual meetings even when shareholders were not able to participate in person. Recent revisions to the SEC's rules, however, have erected unnecessary barriers to investor participation. The SEC should revise Rule 14a-8 to the previous ownership thresholds, which permitted investors who had owned at least \$2,000 worth of stock in a company for at least one year to offer shareholder proposals for inclusion on the company's ballot. Similarly, the SEC should revise proxy resubmission thresholds to the levels that were in place from 1954 until they were changed by the Trump Administration. Prior to those changes, the rules provided that if the proposal was filed once in the last five years, it had to earn 3% support from shareholders to be eligible for resubmission, if filed twice in the last five years, earn 6% support to be eligible for resubmission, and earn 10% support for resubmission three or more times in the last five years.

The rule changes made in late 2020 were adopted over objections from the vast majority of commenters and investors, and without important analysis from the Commission's Division of Economic and Risk Analysis (DERA).²⁶ The revised rules increased the ownership thresholds to \$25,000 in shares for at least one year, \$15,000 for at least two years, or \$2,000 in shares for at least three years, and increased resubmission thresholds to 5%, 15% and 25% for the first, second and third votes, respectively.²⁷

In addition to enhancing investors' ability to offer shareholder proposals through the proxy process, the SEC should consider improving the ability of investors to obtain and rely upon expert advice when considering shareholder votes.²⁸

²⁴ The PRI, *Policy Toolkit* (2020) available at: <https://www.unpri.org/download?ac=12247>.

²⁵ 17 CFR 240.14a-8

²⁶ Securities and Exchange Commission Memorandum, File S7-23-19, Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8 (August 14, 2020) available at: <https://www.sec.gov/comments/s7-23-19/s72319-7645492-222330.pdf>.

²⁷ Securities and Exchange Commission, *Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8*, Release No. 34-89964 (September 23, 2020) available at: <https://www.sec.gov/rules/final/2020/34-89964.pdf>.

²⁸ In particular, the SEC could revise Rule 14a-2(b) to improve the timeliness and content of proxy advice, including by eliminating conflicting "rights" of issuers; Rule 14a-1(l) and Section 14A to clarify that proxy advisers would only be engaged in

Over the years, the investor community has struggled to understand the analysis that drives the Commission's determinations to either exclude an ESG proposal based on the ordinary business exclusion or admit it due to a determination that it pertains to a sufficiently significant policy issue. The SEC should issue guidance to provide clarity to investors as to when shareholder proposals related to ESG issues will be considered significant policy issues. Similarly, the Commission should expand the analysis provided when making decisions on no-action requests under Rule 14a-8 and make them precedential so that investors can structure shareholder proposals on ESG matters to comply with the Commission's views on what matters constitute significant policy issues. The Acting Chair of the Commission recently asked staff to review guidance and regulation related to the shareholder proposal process and proxy voting.²⁹

"soliciting" votes if they have a direct financial stake in securities of the company at issue or otherwise has a financial stake in the outcome; and issue guidance for investment advisers to allow for more reasonable reliance upon advice from proxy advisers. ESG proposals are often excluded from a company's proxy materials on the basis of Rule 14a-8(i)(7), which provides that companies may be permitted to exclude a shareholder proposal if it pertains to the "ordinary business" of the company. According to the SEC, the ordinary business exception serves "to confine the resolution of ordinary business problems to management and the board of directors, since it is impracticable for shareholders to decide how to solve such problems at an annual shareholders meeting." The SEC nevertheless may deny a company's request for permission to exclude a shareholder proposal that pertains to the ordinary business of the company if it pertains to a significant policy issue. It is often on this basis that the Commission allows an ESG-related shareholder proposal to proceed.

²⁹ Securities and Exchange Commission, Speech by Acting Chair Allison Herren Lee, *A Climate for Change: Meeting Investor Demand for Climate and ESG Information at the SEC* (March 15, 2021) available at: <https://www.sec.gov/news/speech/lee-climate-change>

ESG-LABELED PRODUCTS

Investors around the globe are increasingly demanding investment products and funds with specific ESG-related characteristics. This demand has led to explosive growth in financial products and funds that are labeled “ESG”, “Green”, “Sustainable,” or some other description intended to convey a particular sensitivity to one or more ESG factors. Unfortunately, a lack of clear, consistent and comparable definitions of what constitutes each product type is a significant barrier for evaluation by investors, regulators and the public. The SEC should consider working with its fellow federal financial regulators within the U.S. and coordinate with regulators in the European Union and other jurisdictions to adopt a clear taxonomy for investment products and funds.³⁰

In particular, the SEC should consider adopting standardized requirements for registered investment companies and products that are labeled and marketed as “sustainable,” “ESG,” “green” or other ESG-related descriptions. The designations should be based, in part, on the sustainability objectives of the funds, and, when an adviser intends to follow a stated ESG purpose, disclosures to explain the adviser’s methodologies.³¹

ESG-labeled funds grew exponentially in 2020 and now represent a significant percentage of inflows into funds in the U.S. However, different funds have a range of methodologies or processes of incorporating ESG factors into decision-making and investment objectives or policies. These can be confusing to retail and institutional investors.

The PRI believes there is an important role for verification of ESG claims in building confidence among retail savers and institutional asset owners. The SEC could adopt a rule to require all funds (including those based on indices) branded and sold as “sustainable,” “ESG,” “green” or some other designation to meet some independent, objective, verifiable, third-party standard for such designation.

PASSIVE PRODUCTS

Improving transparency of ESG passive products should be viewed as a priority. The PRI’s recent survey of institutional investors on passive financial products highlighted that lack of transparency on the construction of ESG indices was an important issue for asset owners.³² Importantly, the SEC should consider requiring index providers, for indexes that are relied upon as benchmarks or references for investment funds, to disclose the criteria used for inclusion, exclusion and weighting of investments in the index, as well as relevant policies, procedures and potential conflicts of interest.

³⁰ In addition to other U.S. federal financial regulators and regulators in the European Union, the PRI would recommend the SEC review the CFA Institute’s work on ESG fund disclosures as one example of a global industry standard to provide greater product transparency and comparability for investors. The standard is intended to provide a consistent framework to ensure fund providers can outline clearly and consistently ESG features of specific funds. CFA Institute, *Consultation Paper on the Development of the CFA Institute ESG Disclosure Standards for Investment Products* (August 2020), available at: <https://www.cfainstitute.org/-/media/documents/code/esg-standards/consultation-paper-on-esg-disclosure-standards.ashx>.

³¹ See the PRI, File Number S7-04-20: Request for comment on fund names (May 2020) available at: https://unpri.org/Uploads/trw/m/pricomment_fileno.s70420fundnamesmay52020_819131.pdf.

³² The PRI, *How can a passive investor be a responsible investor? ESG & Passive Investment Strategies signatory consultation results* (March 2020) available at: <https://www.unpri.org/download?ac=10145>.

TAXONOMY

The SEC could help establish a standard taxonomy for funds that would further delineate whether and how a fund incorporates ESG information into the investment decision-making process. This could include revising Rule 35d-1 under the Investment Company Act, otherwise known as the “Fund Names Rule”.

Although a definitive list of ESG issues and strategies does not exist, the PRI Reporting Framework includes four actively and passively managed strategies to incorporate ESG: (1) screening, (2) sustainability themed investment, (3) integration of ESG issues, or (4) a combination of the above.

- Screening includes negative/exclusionary screening of certain sectors, companies or practices based on a set of ESG criteria; positive/best-in-class screening for positive ESG performance relative to industry peers; and norms-based screening of investments based on positive or negative performance against minimum standards based on international norms.
- Sustainability themed investment is based on themes or assets related to sustainability (i.e. clean energy).
- Integration of ESG issues is defined by the PRI as “the systematic and explicit inclusion of material ESG factors into investment analysis and investment decisions”.³³

GREEN BONDS

Importantly, investor protection concerns regarding naming of investment funds also carry over to individual investment products, such as so-called “green bonds.” An estimated \$225 billion in “green bonds” were issued in 2019, up more than 20 times since just a few years earlier.³⁴ However, what actually constitutes a “green bond” is often not clear. In the U.S., there is no consistent, reliable standard for determining what an investment product labeled as “green” or some other ESG-related characterization actually does to be “green”. Further, as with investment funds, there is also no government-sanctioned process or party for verification of such status.

To help fill this clear gap in taxonomy, the SEC should consider adopting rules that require all investment products that are marketed, offered, or sold as “sustainable,” “ESG,” “green,” or some other ESG-related characteristic to disclose their specific policies, procedures and practices for assessing how the products “qualify” for such status. Similarly, the SEC should consider establishing criteria and minimum standards for third-party “certifiers” of such status determination.

³³ See Appendix A, *PRI Reporting Framework Main definitions* (2018), also available at:

https://www.unpri.org/Uploads/x/l/q/maindefinitionstoprireportingframework_971173.pdf.

³⁴ Reuters, *September green bond flurry puts market on track for record year* (September 16, 2020) available at:

<https://www.reuters.com/article/us-green-bond-issuance/september-green-bond-flurry-puts-market-on-track-for-record-year-idUSKBN2672T7>.

ACCOUNTING AND AUDITING STANDARDS AND ENFORCEMENT

The U.S. accounting and audit standards setters and enforcement mechanisms have not been updated to fully reflect the unique challenges, including assumptions, assessments and verifications needed, to ensure robust, reliable, comparable disclosures regarding ESG-related risks and opportunities. In particular, the SEC has historically avoided specific ESG-related standards, and has instead generally promoted ad-hoc, customized accounting and disclosure practices based on subjective interpretations of the “materiality” of the potential impacts on individual firms.

However, in addition to its own rulemaking, guidance and enforcement powers, the SEC also oversees the Financial Accounting Standards Board (FASB) and the Public Company Accounting Oversight Board (PCAOB) regarding the development and implementation of accounting and auditing standards, respectively.

As an initial step, the SEC should begin enforcing compliance with rules and guidance. Examples of tools that could be used to make progress on incorporation of ESG into accounting and auditing standards include:

- Existing GAAP standards regarding asset valuation and impairment (which may be particularly relevant for fossil fuel, transportation and other industries that may come to possess “stranded assets”).
- Existing GAAP standards regarding asset life and depreciation (which may be particularly relevant for long-lived assets and financial products that are at greater risk of being “stranded” or severely negatively impacted by climate change and other ESG considerations).
- Corporate commitments, anticipated legal or regulatory changes and other expected future developments that are likely to have material impacts on company operations or financial position.

Similarly, the SEC could identify ESG-related priorities for inspections of audit firms and encourage the PCAOB to do the same. If and as new substantive corporate and investor disclosures are adopted, the SEC could adopt rules regarding auditors’ or any third-party assurance providers’ role in reviewing or assuring those disclosures. Further, the PCAOB could adopt new auditing standards for assurances of compliance with new disclosure requirements by companies, funds, advisers and investment products. If adopted, these should include expectations for “baseline” assumptions and deviations.

The SEC should consider requiring investment advisers of ESG-branded funds or issuers of ESG-branded investment products to obtain third-party “certification” of the asserted funds’ or products’ compliance with the claimed ESG status.

CREDIT RISK ASSESSMENTS AND RATINGS

The proper identification and assessment of risk is a core component of accurate credit ratings, and ESG-related risks are a significant and growing consideration for these risks. The Nationally Recognized Statistical Ratings Organizations generally seek to provide consistent, standardized and comparable assessments on the riskiness of debt to investors.

Credit rating agencies have made progress in enhancing the transparency and the signposting of ESG factors that support their credit rating opinions, supported by the PRI's *ESG in Credit Risk and Ratings Initiative* as well as European regulatory requirements.³⁵ However, whether credit rating agencies give enough weight to these factors in their credit rating opinions is still being debated.

As a result, credit rating agencies may underestimate the impact on creditworthiness of natural disasters exacerbated by climate change, the effects of the transition towards lower carbon economies, of technological changes, or of the coronavirus fallout on the sustainability of current business models. As seen during the Great Recession, credit rating agencies may not adequately capture the impact on credit risk of these ESG factors prior to their manifestation, therefore remaining reactive with their downgrades.

³⁵ The PRI, Credit Risk Ratings Initiative available at: <https://www.unpri.org/investment-tools/fixed-income/credit-risk-and-ratings>. Regulation No 1060/2009 of the European Parliament and of the Council on credit rating agencies (September 2009) available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02009R1060-20190101>.

CONCLUSION

Hardwiring sustainability into financial policymaking is crucial to help accelerate economic recovery, tackle climate change and unravel the social and racial inequities that continue to hinder economic success for so many and hold back the full potential of the U.S. economy. Capital markets participants have key roles to play in responsibly directing capital and investments into a sustainable economy, and federal financial regulators and lawmakers have the ability to revise the U.S. regulatory regime to better promote the integration of ESG factors into investment practices and decision-making. Establishing that ESG factors can be financially material, ensuring disclosure of those factors and clarifying fiduciaries' obligations to integrate ESG into their investment practices would begin to get the United States on track to prepare for risks across the financial system and capitalize on opportunities to enact policy changes that will enhance long-term financial stability and economic growth.

APPENDIX A

PRI Reporting Framework

Main definitions

November 2018

reporting@unpri.org

+44 (0) 20 3714 3187

PRI Association

Registered office: 5th floor, 25 Camperdown Street
London, UK, E1 8DZ Company no. 7207947
T: +44 (0) 20 3714 3220 W: www.unpri.org E: info@unpri.org



UNEP Finance Initiative
Changing finance, financing change



United Nations Global Compact

An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

Table of Contents

Introduction	2
ESG issues	3
Active/ Passive investments	4
ESG incorporation	5
Active ownership and engagement	8
Definitions for service provider reporting	11

Introduction

This document presents some of the main and most frequently used definitions in the PRI Reporting Framework. These definitions are presented here as their use is either frequent and/or key for preparing to report, as well as to understand the reported information by other signatories. In the offline version of the Reporting Framework, you will not find these definitions repeated in each indicator, so it is key that you look at these general definitions here.

ESG issues

Definition	ENVIRONMENT, SOCIAL AND GOVERNANCE ISSUES
<p>A definitive list of environmental, social and governance (ESG) issues does not exist. It would not be possible or desirable to produce a list, or a set of definitions, that claimed to be exhaustive or definitive. Any such list would inevitably be incomplete and would soon be out of date.</p> <p>Nonetheless, the table below provides examples of ESG issues, for guidance purposes. This is intended primarily for signatories who are relatively new to responsible investment and to the PRI. Some modules (e.g. Property) provides examples of ESG issues that are specific to that sector or asset class.</p>	
<p>Environmental (E)</p>	<p>Issues relating to the quality and functioning of the natural environment and natural systems. These include: biodiversity loss; greenhouse gas (GHG) emissions, climate change, renewable energy, energy efficiency, air, water or resource depletion or pollution, waste management, stratospheric ozone depletion, changes in land use, ocean acidification and changes to the nitrogen and phosphorus cycles.</p>
<p>Social (S)</p>	<p>Issues relating to the rights, well-being and interests of people and communities. These include: human rights, labour standards in the supply chain, child, slave and bonded labour, workplace health and safety, freedom of association and freedom of expression, human capital management and employee relations; diversity; relations with local communities, activities in conflict zones, health and access to medicine, HIV/AIDS, consumer protection; and controversial weapons.</p>
<p>Governance (G)</p>	<p>Issues relating to the governance of companies and other investee entities. In the listed equity context these include: board structure, size, diversity, skills and independence, executive pay, shareholder rights, stakeholder interaction, disclosure of information, business ethics, bribery and corruption, internal controls and risk management, and, in general, issues dealing with the relationship between a company's management, its board, its shareholders and its other stakeholders. This category may also include matters of business strategy, encompassing both the implications of business strategy for environmental and social issues, and how the strategy is to be implemented.</p> <p>In the unlisted asset classes governance issues also include matters of fund governance, such as the powers of Advisory Committees, valuation issues, fee structures, etc.</p>
<p>Numerous organisations and projects have identified ESG issues by sector, together with associated key performance indicators. Examples include:</p> <ul style="list-style-type: none"> • The European Federation of Financial Analysts Societies (EFFAS): KPIs for ESG - A Guideline for the Integration of ESG into Financial Analysis and Corporate Valuation • The CFA Institute: Environmental, Social and Governance Factors at Listed Companies - A Manual for Investors • UNEP FI and WBCSD: Translating environmental, social and governance factors into business value <p>ESG research providers and brokers are also well placed to provide advice in this area.</p>	

Active/ Passive investments

Definition	ACTIVELY AND PASSIVELY MANAGED STRATEGIES
<p>Passive strategies</p>	<p>Passive investments are investments which mirror the performance of an index and follow a pre-determined buy and hold strategy that does not involve active forecasting. Examples include investments in broad capital market indices, ESG weighted indices, themed indices, passive managed ETFs or indices with ESG-based exclusions.</p> <p>More detail on ESG integration for passive investors can be found later in this document.</p>
<p>Active - quantitative (quant) strategies</p>	<p>Investment strategies or funds where the manager builds computer-based models to determine whether an investment is attractive. In a pure "quant model" the final decision to buy or sell is made by the model.</p> <p>More detail on ESG integration for active investors can be found later in this document.</p>
<p>Active - fundamental</p>	<p>Fundamental strategies in which investment decisions are based on human judgment. This includes both bottom-up (e.g. stock-picking) and top-down (e.g. sector-based) strategies.</p> <p>More detail on ESG integration for active investors can be found later in this document.</p>
<p>Active - other</p>	<p>Strategies that do not match any of the above strategies. These may be active strategies that combine active quant and active fundamental strategies, or other strategies that you believe do not fit at all the above definitions. You may clarify your strategy in Additional Information field.</p> <p>More detail on ESG integration for active investors can be found later in this document.</p>

ESG incorporation

Definition	ESG INCORPORATION
<p>Incorporation of ESG issues into investment analysis and decision-making processes is covered in Principle 1 of the PRI.</p> <p>Throughout the Reporting Framework, we refer to ESG incorporation <i>as the review and use of ESG information in the investment decision-making process</i>. The Reporting Framework addresses four ways in which this can be done:</p> <ol style="list-style-type: none"> 1. Screening 2. Sustainability themed investment (also referred to as environmentally and socially themed investment) 3. Integration of ESG issues 4. A combination of the above <p>Assets subject to an engagement approach only and not subject to any of the above strategies should not be included in ESG incorporation.</p> <p>To improve standardisation and communication in the responsible investment industry, the PRI is aligning its definitions with those of the Global Sustainable Investment Alliance. These are presented below for convenience.</p>	
Screening of investments	<p>The definitions of the three types of screening in the Reporting Framework are:</p> <ol style="list-style-type: none"> a. Negative/exclusionary screening: The exclusion from a fund or portfolio of certain sectors, companies or practices based on specific ESG criteria; b. Positive/best-in-class screening: Investment in sectors, companies or projects selected for positive ESG performance relative to industry peers; c. Norms-based screening: Screening of investments against minimum standards of business practice based on international norms. Norms-based screening involves either: <ul style="list-style-type: none"> - defining the investment universe based on investees' performance on international norms related to responsible investment/ESG issues, or - excluding investees from portfolios after investment if they are found following research, and sometimes engagement, to contravene these norms. Such norms include but are not limited to the UN Global Compact Principles, the Universal Declaration of Human Rights, International Labour Organization standards, the United Nations Convention Against Corruption and the OECD Guidelines for Multinational Enterprises.
Sustainability themed investing	Investment in themes or assets specifically related to sustainability (for example clean energy, green technology or sustainable agriculture).
Integration of ESG issues	PRI defines this as the systematic and explicit inclusion of material ESG factors into investment analysis and investment decisions
<p>Investment decision-making processes</p> <p>For the purposes of the Reporting Framework, <i>investment decision making processes</i> refers to research, analysis and other processes that lead to a decision to make or retain an investment (i.e. to buy, sell or hold a security), or to commit capital to an unlisted fund or other asset.</p> <p>(Proxy) voting decisions and engagement activities are not classified as investment decisions for the purposes of the Reporting Framework. These decisions fall under Principle 2 of the PRI, relating to active ownership, and within the <i>Listed Equity – Active Ownership (LEA)</i> module of the Framework.</p>	

FURTHER EXPLANATION OF DEFINITIONS FOR ACTIVE STRATEGIES

<p>Screening</p>	<p>Screening covers both screening conducted under a manager’s own policy and client-directed screening.</p> <p>Negative/exclusionary screening and positive/best-in-class screening are based on criteria defined in a variety of ways: by product, activity, sector, geographic region or management practices.</p> <p>Norms-based screening involves either: i) defining the investment universe based on investees’ performance on international norms related to responsible investment/ESG issues, or ii) excluding investees from portfolios after investment if they are found following research, and sometimes engagement, to contravene these norms. Such norms include but are not limited to the UN Global Compact Principles, the Universal Declaration of Human Rights, International Labour Organization standards, the United Nations Convention Against Corruption and the OECD Guidelines for Multinational Enterprises.</p>
<p>Sustainability themed investing</p>	<p>Sustainability themed investing involves the selection of assets that contribute to addressing sustainability challenges such as climate change or water scarcity. Funds can either be single-themed or multi-themed. For the purpose of this Reporting Framework, we use interchangeably the term environmental and social themed and sustainability themed investments.</p>
<p>Integration of ESG issues</p>	<p>Integration of ESG issues encompasses the use of qualitative and quantitative ESG information in investment processes, with the objective of enhancing investment decision-making. Integration of ESG issues can be used to inform economic analysis and industry analysis. It can be used at the portfolio level, by taking into account ESG-related trends such as climate change, or at the stock, issuer, or investee level. The term is used interchangeably with ESG integration or integrated analysis.</p> <p>Integrated analysis for active stock-picking or other equity investments includes analysing how ESG issues can affect a company’s balance sheet, income statement or cash flow models, by affecting costs, revenues, and business growth assumptions (i.e. in the estimation of a company’s fundamental value). Integrated analysis for active bond-picking and other debt funds involves analysing how ESG issues can affect an issuer’s creditworthiness. This type of analysis can also be used by funds that pick bond issuers using quantitative modelling. Integrated analysis for both equities and debt includes an assessment of a company’s quality of management and the business risks and opportunities it faces related to ESG issues, allowing comparisons between companies.</p> <p>For examples of how investors are conducting integrated analysis for listed equities, see Integrated Analysis: How Investors Are Addressing Environmental, Social and Governance Factors in Fundamental Equity Valuation, published by the PRI in February 2013.</p>
<p>Combined approaches</p>	<p>Combined approaches might include for example:</p> <ul style="list-style-type: none"> • Establishing a sustainable agriculture thematic fund that screens out companies involved in producing tobacco and uses integrated analysis to select companies for inclusion in the fund. • Running a fund that applies 20 negative screens to determine the investible universe and uses integrated analysis to select companies for investment from within the investible universe. • Running a global equities fund using integrated analysis to select stocks combined with a norms-based approach, investigating any serious alleged breaches of selected international norms and divesting companies found to be in serious breach of a norm (often after engagement).

FURTHER EXPLANATION OF DEFINITIONS FOR PASSIVE STRATEGIES

<p>Screening</p>	<p>Screening may include the use of indices constructed from an eligible universe based on the ESG characteristics of a company or country, but in which ESG issues do not play a part in the weighting of those companies or countries within the index. This may include indices constructed using ESG best-in-class or positive selection methodologies which identify securities for index inclusion (e.g. FTSE4Good, Dow Jones sustainability and MSCI ESG indices) or indices that exclude particular companies or countries (e.g. on the basis of products or activities). Exclusions may also be activity-based (i.e. exclude securities on the basis of their industry or business activities, for example, tobacco or controversial weapon screens), or location-based (i.e. exclude securities from companies who operate in certain countries, or the sovereign debt from those countries). Alternatively, there may be norms-based exclusions (i.e. indices which exclude securities of issuers considered to have broken certain minimum standards of business conduct based on international norms, such as the UN Global Compact).</p>
<p>Sustainability themed investments</p>	<p>Sustainability themed investments cover passive funds investing in companies linked to specific themes (e.g. indices focused entirely on environmental and social themes such as clean technology, climate change, microfinance and impact investing).</p>
<p>Integration of ESG issues</p>	<p>Integration of ESG issues typically alternative weighted ESG indices in which constituent security weights take account of the ESG characteristics of the company or country.</p>

Active ownership and engagement

Definition	ACTIVE OWNERSHIP AND ENGAGEMENT
Active ownership	Active ownership is the use of the rights and position of ownership to influence the activity or behaviour of investees. This can be applied differently in each asset class. For listed equities it includes both engagement and (proxy) voting (including filing shareholder resolutions). For other asset classes (e.g. fixed income), engagement may still be relevant while (proxy) voting may not.
Engagement	Engagement refers to interactions between the investor and current or potential investees (which may be companies, governments, municipalities, etc.) on ESG issues. Engagements are undertaken to influence (or identify the need to influence) ESG practices and/or improve ESG disclosure.
(Proxy) voting and shareholder resolutions	Voting refers to voting on management and/or shareholder resolutions as well as filing shareholder resolutions.

FURTHER EXPLANATION OF DEFINITIONS FOR ENGAGEMENT

Do not include the following as engagements:

- Interactions with companies for data collection and/or research purposes related to buy/hold/sell/weight decisions.
- Standard questionnaires sent to companies for the purposes of information gathering and investment decision-making related to Principle 1 only (e.g. on products, or ESG policies and performance, for screening purposes).
- Attendance at a company presentation, AGM or other company meeting without interactions or discussion.
- CDP's disclosure requests on GHG emissions, water and forests. These are not captured as engagements but are reported in Strategy and Governance (SG).
- Press releases an investor may publish regarding a practice an investee is undertaking which the investor is aiming to change.

Interactions intended to influence public policy or industry bodies defining best practices may not necessarily relate to specific underlying assets. Hence, do not report these in the asset class modules, but in the Strategy and Governance (SG) module.

ENGAGEMENTS SPLIT BY WHO CONDUCTS THEM

There are many different configurations of engagement. Investors engage with companies directly in their own name, in collaboration with other investors and through commercial service providers. The distinctions between these are not always clear-cut. Please use the definitions below and your best professional judgement when deciding how to classify your engagement. Review the process indicators for each category (LEA 03-04 for internal; LEA 05-06 for collaborative; and LEA 07-08 for service providers) and determine which indicator/s best fit your business model.

Please contact the Reporting and Assessment team if you require additional clarification.

<p>Individual/ Internal staff engagement</p>	<p>The defining characteristics of an individual/internal staff engagement are:</p> <ul style="list-style-type: none"> • it is carried out by your internal staff alone, with no involvement or support from other investors, investor networks or service provider • it is conducted in the name of your organisation (i.e. the companies with which you engage can identify your organisation individually) and you do not act on behalf of other organisations. <p>Joining the CDP should not be counted as an engagement but reported as part of the way you support responsible investment in Organisational Approach OA10. However, if your organisation engages in its own name with companies on their carbon emissions, water or forest footprint disclosure as a follow-up to CDP disclosure requests, you should report these engagements as individual/internal staff engagements.</p>
<p>Collaborative engagement</p>	<p>Collaborative engagement is engagement that an investor conducts jointly with other investors. This might include:</p> <ul style="list-style-type: none"> • groups of investors working together without the involvement of a formal investor network or other membership organisation. • groups of investors working together with the support of a formal investor network or other membership organisation, including the PRI initiative.. <p>Collaborative engagements might require different levels of involvement from participating investors. In some examples, formal networks provide support in terms of coordinating calls, defining objectives, tracking activities and measuring outcomes. In other circumstances, these activities are managed independently by investors in the coalition. Additionally, some members might have more a leading role than others (see further definition under engagement effort), Nonetheless, collaborative engagements included in this category should require the individual members to allocate some resources to and the engagement/or share information and expertise within the group.</p> <p>Collaborative engagements posted on the Clearinghouse and/or coordinated by the PRI staff (i.e. Investor Engagements team) should be included in this indicator.</p> <p>Joining the CDP should not be counted as an engagement but reported as part of the way you support responsible investment in Organisational Approach OA10. However, if your organisation engages with a group of investors in its own name with companies on their carbon emissions, water or forest footprint disclosure as a follow-up to CDP disclosure requests, you should report these engagements as collaborative engagements.</p>
<p>Service provider engagement</p>	<p>Service provider engagements include engagements conducted via:</p> <ul style="list-style-type: none"> • commercial parties that provide stand-alone engagement services, without managing their clients' underlying assets. • investor organisations that conduct engagement on their members' behalf, and which have an explicit mandate from their members to represent them. <p>These include engagements conducted entirely on an outsourced basis as well as those facilitated by the service provider but the investor's own staff undertake some of the engagement activity.</p>

ENGAGEMENT INTENSITY AND EFFORT

Investors interact with companies and issuers at different levels of intensity and effort. The levels of intensity and effort are defined below.

Definition	ENGAGEMENT INTENSITY
<p>Comprehensive engagement</p> <p>(for all engagement types)</p>	<p>A comprehensive engagement includes multiple, substantive, detailed discussions or interactions with a company (e.g. letters, meetings and calls) relating to a particular ESG issue.</p>

Definition	ENGAGEMENT EFFORT
<p>Leading role</p> <p>(for collaborative engagements)</p>	<p>Defined as writing and/or following up on joint letters, regularly joining group conference calls, leading dialogue with companies, participating in some meetings with companies organised by other investors, and sharing relevant information on the topic and companies with other members of the collaboration.</p> <p>Note that leading investors cover all the activities mentioned above. Joining group conference calls, participating in some meetings with companies organized by other investors and sharing information alone will not constitute a leading role.</p>
<p>High involvement engagements</p> <p>(for service provider engagements)</p>	<p>Defined as situations where you:</p> <ul style="list-style-type: none"> • spend significant time and effort setting goals and objectives for specific engagements and monitor them proactively; and/or, • wrote or followed up on joint letters with the service provider (possibly alongside other investors); and/or, • regularly joined group conference calls; and/or, • participated in some meetings with companies organised by the service provider.

Definitions for service provider reporting

Definition	
Core business offering(s)/main business activity	<p>The Service Provider Reporting Framework will ask organisations to select which their core business offering(s) or main business activity is.</p> <p>For dedicated service providers this indicates the main services that you offer to clients that form an essential part of your organisation's activities. The core business offering/main business activity is often the main source of a company's profits and/or revenue and sometimes the activity the company was originally set up to carry out, i.e. their main reason for being.</p> <p>For investment managers, this relates to the services that you also provide that form a substantial part of your non-investment business activity.</p>

Definition	SERVICE PROVIDER CATEGORIES
Investment Consultancy (IC)	<p>Provision of financial or non-financial advice on a retainer or ad hoc basis relating to environmental, social, and/or governance aspects of investment activity. Services provided do not include active investment management and fiduciary management, or CSR/corporate sustainability services. Examples of investment consultancy services include, custodial services, investment policy development, strategic asset allocation, investment research and manager selection and monitoring.</p>
Active Ownership Services (AOS)	<p>Active ownership is the use of the rights and position of ownership to influence the activity or behaviour of investees.</p> <p>Active ownership services provided at any stage of engagement activities for investors, including engagement or engagement support services, research, and advice. Activity can be individual or collaborative. Services related to any stage of proxy voting, including voting execution and voting advisory. This category includes advice or services related to shareholder resolutions. Activity may also include engagement with policy makers or regulators. This category does not include service providers that only inform their clients of voting outcomes, e.g. as part of a custodial role or similar, or service providers that only provide a platform for voting.</p>
Reporting and Assurance (REP)	<p>Services relating to the preparation and presentation of corporate, sustainability or integrated reporting, and financial reporting for clients. This category also includes audit, and external assurance services for clients.</p> <p>Other types of reporting, such as reporting on assets and the performance of investment managers is not covered by this category.</p>
Research and Data Provision (RDP)	<p>Collection and preparation of raw data, ratings, or analysis of ESG related information or issues. Offerings may be off the shelf or client tailored. This category includes brokerage firms. Activities that are intended to provide strategic advice or affect investment strategy or key decision making should be reported under Investment Consulting Services instead.</p> <p>Examples of research and data provision services include, but are not limited to, analysis, benchmarking reports, ratings, raw data and surveys.</p>
Other	<p>In this instance, 'Other' will apply to any service provider signatory that does not offer any of the above services. If you report 'Other' in the Service Provider Reporting Framework, a separate indicator will be activated that will allow you to describe this business activity.</p>