PRI'S RESPONSE TO THE OECD CONSULTATION PAPER ON BUSINESS RESPONSIBILITIES AND INVESTMENT TREATIES

February 17, 2020

INTRODUCTION

The United Nations-backed Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI has over 2800 signatories (pension funds, insurers, investment managers and service providers) globally with approximately US $90 trillion in assets under management.

Responsible investment explicitly acknowledges the relevance to the investor of environmental, social and governance (ESG) factors in investment decision-making for the long-term health and stability of financial markets.

The PRI welcomes the opportunity to contribute evidence to the OECD Consultation Paper on Business Responsibilities and Investment Treaties.

Within this consultation paper, the PRI provides comments to the chapter 5, "Investor, business, trade union and civil society action", specifically on the topic of "sustainable or 'environmental, social and governance' (ESG) investing".

ABOUT THE CONSULTATION

Investment treaty policy makers are increasingly faced with pressures to integrate policies relating to business responsibilities into investment treaties. As policy makers contemplate whether and how to respond in their particular field, they need to understand the broader framework for business responsibilities.

In October 2019, governments participating in the OECD-hosted Investment Roundtable initiated work on business responsibilities and investment treaties. Business and human rights (BHR) and responsible business conduct (RBC) are fast-developing fields with converging approaches to business responsibilities. The convergence is demonstrated in the alignment of the OECD Guidelines for Multinational Enterprises, the UN Guiding Principles on Business and Human Rights and core ILO standards. Governments, business, trade unions and civil society are all engaged in efforts in this area.

The OECD is now inviting comments from business, trade unions, civil society and experts on a consultation paper that provides governments with a preliminary overview of the fields of BHR and RBC. The paper considers a range of recent government actions, including in response to growing calls for policy coherence across government, as well as a few important stakeholder initiatives. The paper also provides a brief overview of relevant investment treaty developments.[1]

[1] http://www.oecd.org/investment/public-consultation-on-business-responsibilities-and-investment-treaties.htm

PRI'S DEFINITION OF RESPONSIBLE INVESTMENT

The PRI defines responsible, or sustainable investment as a strategy and practice to incorporate environmental, social and governance (ESG) factors in investment decisions and active ownership.[2]

Responsible investment aims to combine better risk management with improved portfolio returns, and to reflect investor and beneficiary values in an investment strategy. It complements traditional financial analysis and portfolio construction techniques.

Responsible investment is driven by:

- **Materiality**: There is a growing recognition in the financial industry and in academia that ESG factors influence investor returns. An analysis of over 2,000 academic studies on how ESG factors affect corporate financial performance found "an overwhelming share of positive results," with just one in 10 showing a negative relationship.[3] PRI-commissioned research indicates that engaging with companies on ESG issues can create value for both investors and companies, by encouraging better ESG risk management and more sustainable business practices.[4]
- **Client demand**: Beneficiaries and clients are increasingly calling for greater transparency about how and where their money is invested. This is driven by growing awareness that ESG factors influence company value, returns and reputation, and by an increasing focus on the environmental and social impacts of the companies they are invested in. Negative screening, which excludes certain sectors, companies or practices, is the most widespread approach to integrating values in a portfolio or fund.
- **Regulation**: Since the mid-nineties, responsible investment regulation has increased significantly, with a particular surge in policy interventions since the 2008 financial crisis. Regulatory change has also been driven by a realisation among national and international regulators that the financial sector can play an important role in meeting global challenges such as climate change, modern slavery and tax avoidance.

The responsible investment industry is evolving rapidly, resulting in **misconceptions** about what it entails, including:

- **It involves investing in a specific investment strategy or product**. Responsible investment does not necessarily require investing in a specific strategy or product. It simply involves including ESG information in investment decision-making and stewardship practices, to ensure that all relevant factors are accounted for when assessing risk and return. The way in which an investor practices responsible investment varies widely.
- **It leads to lower investment returns**. Responsible investment does not require sacrificing returns; evidence demonstrates that it should, in fact, *enhance* risk and return characteristics. Investors apply a range of techniques to identify risks and opportunities that might remain undiscovered without the analysis of specific ESG data and broad ESG trends.
- **It is the same as ethical, socially responsible and impact investing**. There are many terms associated with the plethora of investment approaches that consider environmental, social and governance issues. Most lack formal definitions, and they are often used interchangeably. A key to understanding how responsible investment is broader than these concepts is that where many make moral or ethical goals a primary purpose, responsible investment can and should also be pursued by the investor whose sole focus is financial performance.

---

[2] https://www.unpri.org/pri/an-introduction-to-responsible-investment
[3] https://download.dws.com/download?elib-assetguid=714aed4c2e83471787d1ca0f1b559006&wt_eid=2156623951900953270&wt_t=1566240624353
[4] https://www.unpri.org/academic-research/how-esg-engagement-creates-value-for-investors-and-companies/3054.article

PRI'S RESPONSE TO CHAPTER 5, SECTION 5.1 "SUSTAINABLE OR 'ENVIRONMENTAL, SOCIAL AND GOVERNANCE' (ESG) INVESTING"

Paragraph 297:

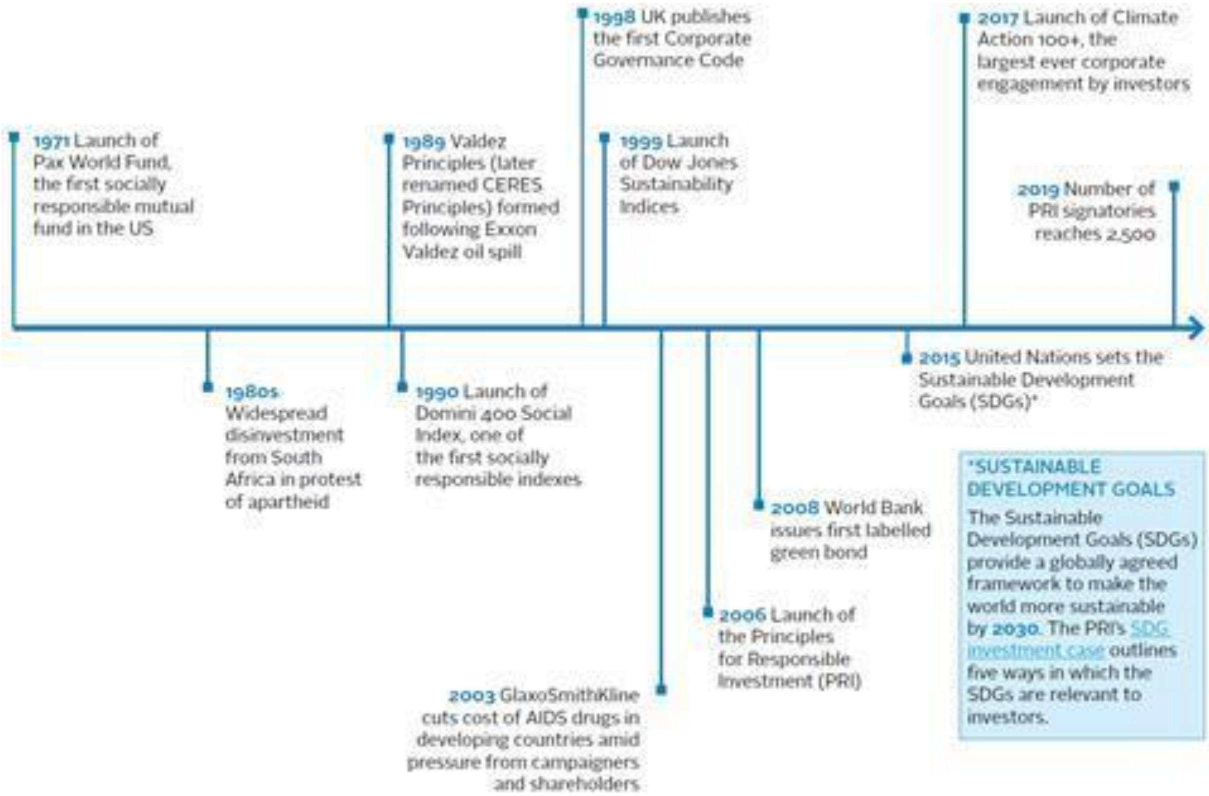
"297. There is broad interest today among investors and asset managers in environmental, social and governance (ESG) investment. ESG investing grew out of the UN Global Compact. The goal of the initiative was to find ways to integrate ESG considerations into capital markets. The number of funds using ESG factors increased from fewer than 50 in 2,000 to nearly 1,100 in 2016. Today, ESG investing is estimated at over USD 20 trillion in assets under management or around a quarter of all professionally managed assets around the world. "

We recommend to use the definition of responsible investment instead of 'ESG investing' throughout this section, as presented above and available in detail on PRI's website.[5] PRI's definition is implemented by its 2800 signatories around the world. The use of standard definitions will avoid confusion around the key theme of this section. We recommend replacing the first sentence with:

"There is broad interest today among investors and asset managers in responsible investment and the incorporation of environmental, social and governance (ESG) in investment decision making."

On the origins of responsible investment, we recommend noting that the modern history of responsible investment is related to the development of socially responsible mutual funds in the 1970s.

Key milestones of the evolution of responsible investment include:



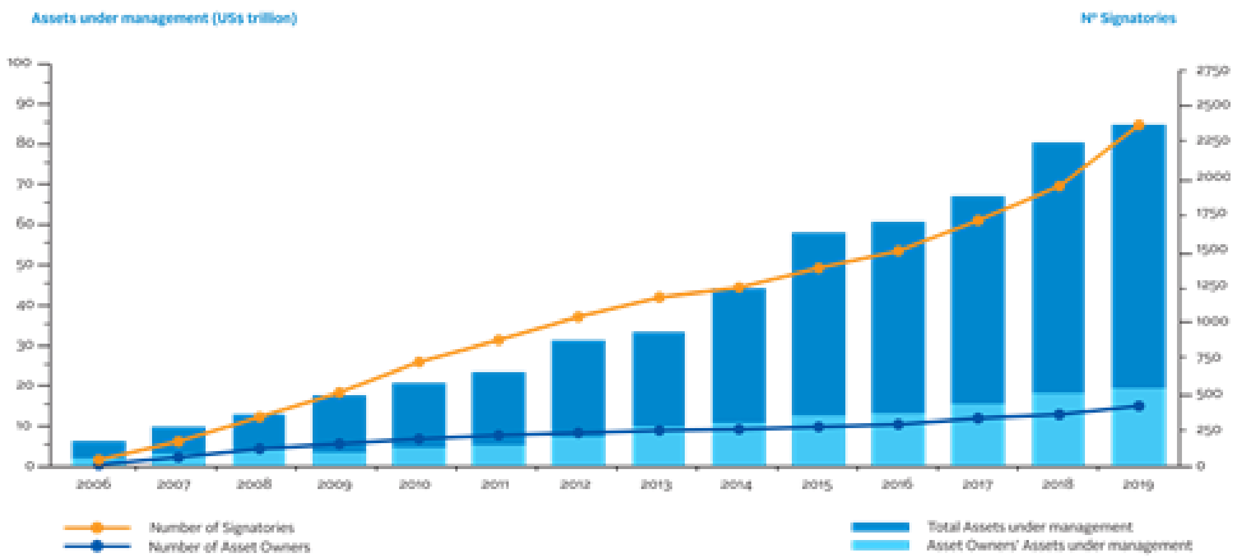
On the growth in responsible investment policies, data is available in our regulation database:

https://www.unpri.org/sustainable-markets/regulation-map

PRI's signatories have reached 2800 in 2020 with 90 trillion USD in AUM:

---

[5] https://www.unpri.org/pri/an-introduction-to-responsible-investment/what-is-responsible-investment



Paragraph 298:

“298. ESG investing is promoted by numerous initiatives. The Principles for Responsible Investment (PRI), dating from 2006, are a private initiative supported by UN agencies. It seeks to understand the investment implications of ESG factors and to support an international network of investor signatories in incorporating these factors into their investment and ownership decisions. The Sustainable Stock Exchange Initiative (SSEI), seeks to integrate ESG considerations into stock exchange policies. Some exchanges now require ESG disclosure for listed companies or provide guidance on reporting.”

We recommend the use of the term responsible investment instead of ESG investing. We also suggest adding the following information about the PRI:

“The number of PRI signatories reached 2800 in 2020, with 90 trillion USD of AUM. 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.”

Paragraph 299:

“299. Fund managers and other institutional investors were initially reluctant to embrace the concept. Consideration of ESG factors is increasingly seen as a legitimate part of the fiduciary duty of institutional investors. Views that fiduciary duties are limited to the maximization of shareholder value without regard to environmental or social impacts, or governance issues such as corruption, are receding.”

We recommend changing the last part of the last sentence from ‘are receding’ to ‘are no longer supported’.

We also recommend referring to the latest analysis on fiduciary duty by the PRI and UNEP FI as part of their four year research programme[6] *on this topic, which concluded 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.*
- *Understand and incorporate beneficiaries’ and savers’ sustainability-related preferences, regardless of whether these preferences are financially material.*
- *Encourage high standards of ESG performance in the companies or other entities in which they invest.*

---

[6] https://www.unpri.org/sustainable-markets/fiduciary-duty

- *Support the stability and resilience of the financial system.*
- *Report on how they have implemented these commitments.*

Paragraph 300:

"300. While there is strong consumer demand and a clear market response, it is unclear that investors are getting what they seek because the quality of information about ESG performance can be uncertain. Funds and agencies marketing ESG ratings use non-public algorithms that are difficult to evaluate. Some academic work has shown that the same company can be at top of one service's ratings and at the bottom of another's.159 The ESG factors have generally been developed autonomously by financial market service providers actors without regard for agreed frameworks such as the UNGPs or Guidelines. Uncertainty about the measurement of ESG performance by companies remains a major issue that affects the transmission of consumer demand to company performance."

We recommend to add in this paragraph the need for an international dialogue on ESG reporting harmonisation and standardisation. Multilateral organisations and ESG reporting stakeholders should work together to create a global, standardised and comparable corporate ESG reporting framework, including standardised ESG indicators and underlying methodologies.

Paragraph 301:

"301. Various initiatives seek to produce standardised forms of disclosure. For example, the Global Reporting Initiative (GRI) was launched in 2000. Today, 80% of the world's largest corporations use GRI standards. Other include the International Integrated Reporting Initiative (IIRC) and the US-based Sustainability Accounting Standard Board (SASB). These voluntary initiatives reflect regulatory disclosure requirements in key jurisdictions and extend further."

We recommend adding the following information to this paragraph:

IOSCO, the International Organisation of Securities Commissions, has published in 2019 a statement[7] on ESG disclosure and a report[8] encouraging securities regulators to require ESG disclosures from issuers. Financial market authorities around the world are updating their listing rules and disclosure requirements to introduce mandatory ESG disclosures. Further information on ESG disclosure consultations by market authorities can be found on PRI's briefings and consultations page.[9]

Paragraph 302:

"302. There have been many efforts to determine the impact of ESG issues on financial performance of companies. Some recent studies find that ESG investments perform at least as well as others, which has heightened and broadened investor interest."

The PRI has developed a summary of top academic research on responsible investment, available on PRI's website.[10]

The PRI has experience in responsible investment policy and is willing to support the OECD in further promoting policies that support responsible investment and business conduct.

Any question or comments can be sent to policy@unpri.org.

---

[7] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD619.pdf
[8] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD630.pdf
[9] https://www.unpri.org/sustainable-markets/briefings-and-consultations
[10] https://www.unpri.org/academic-research/top-academic-resources-on-responsible-investment/4417.article