Principles for Responsible Investment

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Responsible investment and public policy

Investors have long recognised that it is in their interest to engage in public policy debates- for example on market-wide codes and standards on corporate governance. Many investors also acknowledge that it is their long-term financial interest to encourage appropriate domestic and international government action on environmental issues such as climate change and social issues such as human rights. The global financial crisis, which has demonstrated the potential for macro-level ESG and systemic issues to undermine investors' interests, has added a new dimension to the rationale for investors to engage with policy-makers.

Responding to these issues requires investors to move beyond the environmental, social and governance (ESG) issues associated with individual investments and consider whether and how they might address broader issues relating to the structure, function and governance of markets as a whole. Critically, it requires that investors play a much more proactive role in public policy debates, including supporting regulatory interventions where this is likely to produce the best outcomes.

Investors are increasingly recognising the critical role that public policy plays in delivering stable, well-functioning and well-governed markets.. In 2012, the PRI's Advisory Council revised the initiative's mission statement and objectives to reflect the belief that a sustainable global financial system is a necessity for long-term value creation, is one that rewards long-term responsible investment and has positive impacts for the environment and society as a whole. The PRI has committed to developing a research and public policy programme focused on accelerating the transition to a sustainable global financial system (PRI, 2012: 6-7).

Other investor groups are already engaged in public policy debates. For example, in Europe, the Institutional Investors Group on Climate Change (IIGCC) brings "… investors together to use their significant collective influence to engage in dialogues with policymakers, investors and companies to accelerate the shift to a low carbon economy". The IIGCC and its sister networks in the United States and in Australia/New Zealand have a long track record of engaging with policy makers to encourage them to implement the policy measures necessary to avert the most serious consequences of climate change. The rationale for this engagement is clear, with the 2011 Global Investor Statement on Climate Change stating: "Climate change presents major long-term risks to the global economy and to the assets held by global investors. At the same time, well designed and effectively implemented long-term climate change and clean energy policy ("investment-grade policies") will not only present significant opportunities for investors in areas such as cleaner and renewable energy, energy efficiency and decarbonisation, but will also yield substantial economic benefits".

The global financial crisis has triggered renewed investor interest in the market frameworks necessary for pension funds and other long-term savings institutions to achieve their core objectives of delivering financial security in retirement, or income at other stages in life, for millions of people. To do this, these investors depend on markets that are stable, well regulated, transparent and fair. An example of investor engagement on this type of public policy issue is presented in Box 1.

Box 1: Investor coalition to address European Commission (EC) reforms around the European Union (EU) audit market

Between late 2008 and 2010, 114 banks in the EU received capital injections. All of these banks had previously received clean audit reports, raising the question of the actual role being played by auditors in ensuring the financial stability of banks and in acting as watchdogs for investors or other stakeholders.

Increasingly policy-makers have pointed to high levels of concentration in the audit market, low levels of transparency, long audit firm tenure (48 years on average for the FTSE100), high levels of non-audit fees and evidence of regulatory capture as deeply concerning. In November 2011, the EC put forward some radical proposals to reform the EU audit market.

USS (the Universities Superannuation Scheme) and other long term investors welcomed the EC's proposals, but felt some were too prescriptive and inflexible. Together, a coalition of investors and investor associations (the coalition now numbers 22 organisations, representing tens of millions of savers and pensioners) put together a Group Position Paper setting out proposals for audit sector reform, with a particular focus on ensuring auditor independence and accountability to shareholders.

In September 2012, the European Parliament published Draft Reports on the EC's proposals, which seriously weakened some of the key provisions in its earlier proposals. The investor coalition subsequently wrote to Commissioner Barnier, expressing concerns about these changes and pressing for a much stronger approach to be adopted.

You can read more about this collaboration, including the Group Position Paper on the PRI Initiative's collaborative engagement platform.

The example in Box 1 also points to the challenges faced by investors when engaging with policy makers, which is that investors are just one voice in these debates. For investors to be effective, it requires that they have well informed and well developed positions, that they have a significant level of support (both in terms of numbers and assets under management) across the industry, and that they recognise that such lobbying is an issue of collective responsibility and collective benefit.

Universal Ownership

The concept of Universal Ownership provides a useful analytical framework for understanding why certain investors have an interest in stable, well-functioning and well governed social, environmental and economic systems. A Universal Owner is a large institutional investor whose holdings are so broad and diverse that they own, in effect, a fairly representative slice of the capital stock of the economy as a whole. The Universal Owner hypothesis is based on the idea that diversified investors' returns are linked to the prosperity of the economy and capital markets as a whole. While these investors may benefit from a company externalising costs onto other companies or onto society as a whole, they may also be affected by the taxes, higher insurance premiums, higher prices or other impacts that result from these externalities. These, in turn, will reduce overall returns because these externalities are adversely affecting other investments in the portfolio or the market as a whole. In these types of situations, investors should take account of these system-level factors in order to protect the interests of their investments. The specific actions that investors take may include engaging with the companies they are invested in to encourage them to minimise their impacts, or engaging with policy-makers to minimise wider market-related impacts.

References/Further Reading

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