Principles for Responsible Investment

ASSET OWNER TECHNICAL GUIDE

INVESTMENT MANAGER MONITORING GUIDE

UNEP FINANCE INITIATIVE
United Nations Global Compact
An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

THE SIX PRINCIPLES

PREAMBLE TO THE PRINCIPLES

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

1 We will incorporate ESG issues into investment analysis and decision-making processes.

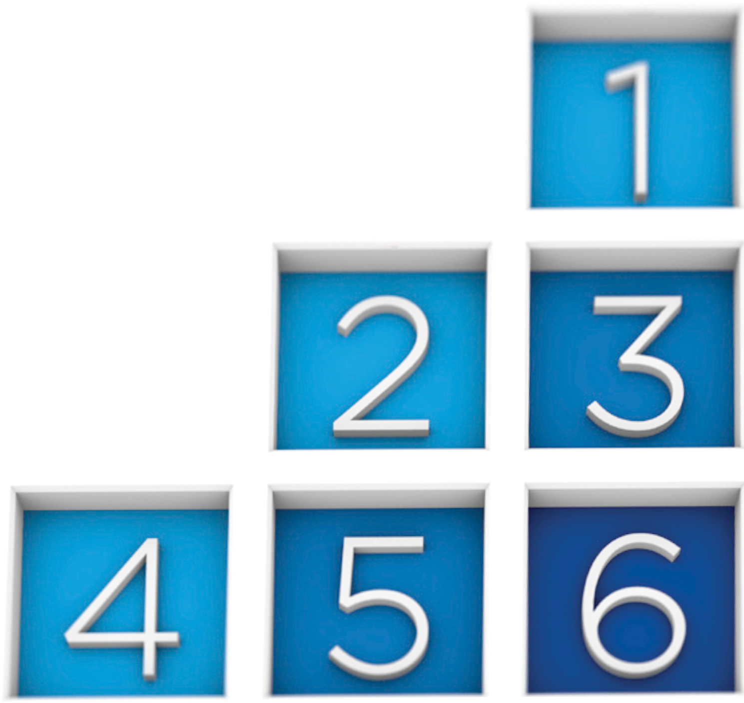
2 We will be active owners and incorporate ESG issues into our ownership policies and practices.

3 We will seek appropriate disclosure on ESG issues by the entities in which we invest.

4 We will promote acceptance and implementation of the Principles within the investment industry.

5 We will work together to enhance our effectiveness in implementing the Principles.

6 We will each report on our activities and progress towards implementing the Principles.



PRI's MISSION

We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

CONTENTS

EXECUTIVE SUMMARY

A growing number of asset owners now expect their investment managers to incorporate ESG factors into their investment processes. This means that ESG needs to be at the core of the relationship between the asset owner and the investment manager – and that ESG considerations need to be addressed at every stage of that relationship, from setting the initial investment strategy, to drafting requests for proposals, to selection, appointment and monitoring.

Thorough and consistent monitoring is critical to ensure the delivery of the terms and conditions on which the manager was appointed and that it is meeting the asset owner's requirements. Regular monitoring of and reporting by the investment manager will provide the asset owner with insight and necessary detail to understand the manager's approach to responsible investment, its alignment to the mandate and the investment management agreement (IMA), and to its stated investment principles.

Leading practice is developing quickly. The 2019 PRI Leaders' Group provides examples from asset owners in our signatory base who have demonstrated leading practice in monitoring (see Box 1: The PRI Leaders' Group).

BOX 1: THE PRI LEADERS' GROUP

The PRI has identified The PRI Leaders' Group 2019, which highlights asset owner leaders that have developed rigorous follow-up procedures to reduce reputational and management risk, and who have detailed policies for frequently monitoring managers' performance through on-site interviews, calls and due diligence questionnaire (DDQ) reviews. Those leaders have set their own minimum criteria for evaluating manager performance; this guide seeks to promote similar monitoring across asset owners and investment managers, with the aim of streamlining and easing reporting.

The aim of this manager monitoring guidance is to:

- Promote consistency in reporting formats for both asset owners and investment managers;
- Help asset owners understand if the manager's approach to responsible investment is aligned with its own;
- Reduce the number of variances in requests for information from investment managers; and
- Promote comparability between managers.

This guidance should also help asset owners in structuring and compiling information from several investment managers for the purpose of reporting on ESG performance to clients and beneficiaries.

These guides are divided into five modules (see Figure 1). They should be read in conjunction and will act as a road map for asset owners to thoroughly embed ESG issues in their investment processes and in the relationships between them and investment managers.

Module 1 describes a process followed by an asset owner to develop a responsible investment policy and strategy. This also includes the development of a strategic approach to asset allocation that incorporates ESG considerations.

Module 2 addresses the internal process of establishing mandate requirements, including key ESG considerations that will govern the investment manager, and drafting the RFP to reflect those requirements at a high level.

Module 3 focuses on the manager selection process to identify the investment manager that has the responsible investment attributes in place to meet the ESG requirements specified by the asset owner in Module 2.

Module 4 describes the manager appointment process to transfer the mandate requirements specified in the mandate into legal documentation.

Module 5 sets out a harmonised approach to investment manager monitoring, including tools and practical recommendations.

Figure 1: The PRI asset owner programme

MODULE 1
Policy, investment strategy and strategic asset allocation

- Writing a policy
- Defining a strategy
- Developing an approach to strategic asset allocation

MODULE 2
Mandate requirements and RFPs

- Developing mandate ESG requirements
- Creating RFPs for manager search

MODULE 3
Manager selection

- Longlist of managers
- Shortlist of managers
- In-depth due diligence

MODULE 4
Manager appointment

- Embedding ESG requirements into legal documents
- Sample model contracts

MODULE 5
Manager monitoring

- Identifying minimum reporting disclosures
- Considering asset class-specific reporting

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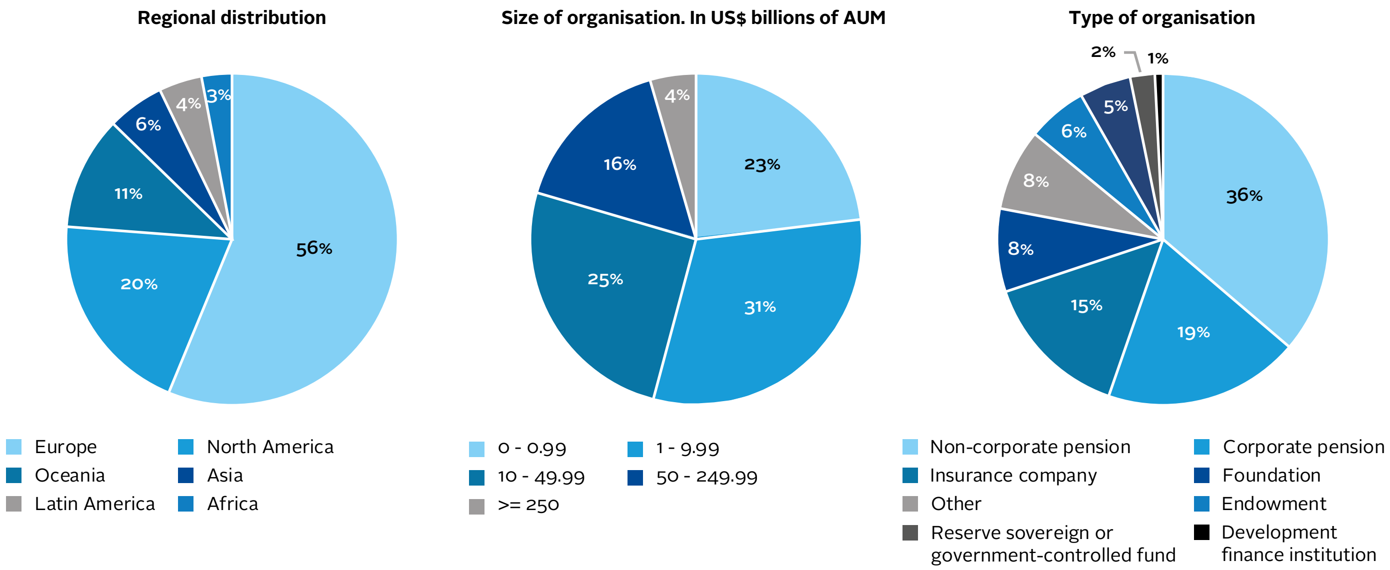
ABOUT THIS GUIDE

This guide has been written to help asset owners develop an investment manager monitoring process. It provides a framework and an indicative list of questions to include in the formal monitoring and reporting structure. Where applicable, asset owners should use the proposed guidance in a tailored form, adjusted for their specific needs. The steps within this guide should enhance an asset owner's current monitoring approach and may also identify the strengths and weaknesses of that approach.

This guide has been developed based on desk research, a review of current industry guidance from the PRI and third-party sources, and both public and confidential information provided by PRI signatories through a number of channels. These include discussions at an asset owner roundtable event during the PRI in Person conference in 2019, and a review of responses from the PRI Reporting and Assessment Framework.[1] This latter examined responses from 379 asset owner signatories (see Figure 2). These information sources have provided leading practices from an array of asset owners around the world, which are referenced on a non-attributable basis.

Sources for the disclosure questions proposed in this guide can be found in Box 2: Disclosure resources. Some disclosures, diagrams and tables have been developed from the Reporting and Assessment Framework as well as from public or confidential information provided by PRI signatories.

Figure 2: PRI asset owner signatory base, 2019



This guide was produced as part of the PRI's programme to support asset owners in their implementation of the PRI's six principles and their efforts to help build a sustainable financial system. It will be equally relevant for investment consultants and fund-of-funds managers tasked with monitoring investment managers. Investment managers themselves might find this guide helpful in preparing for requests from their client base.

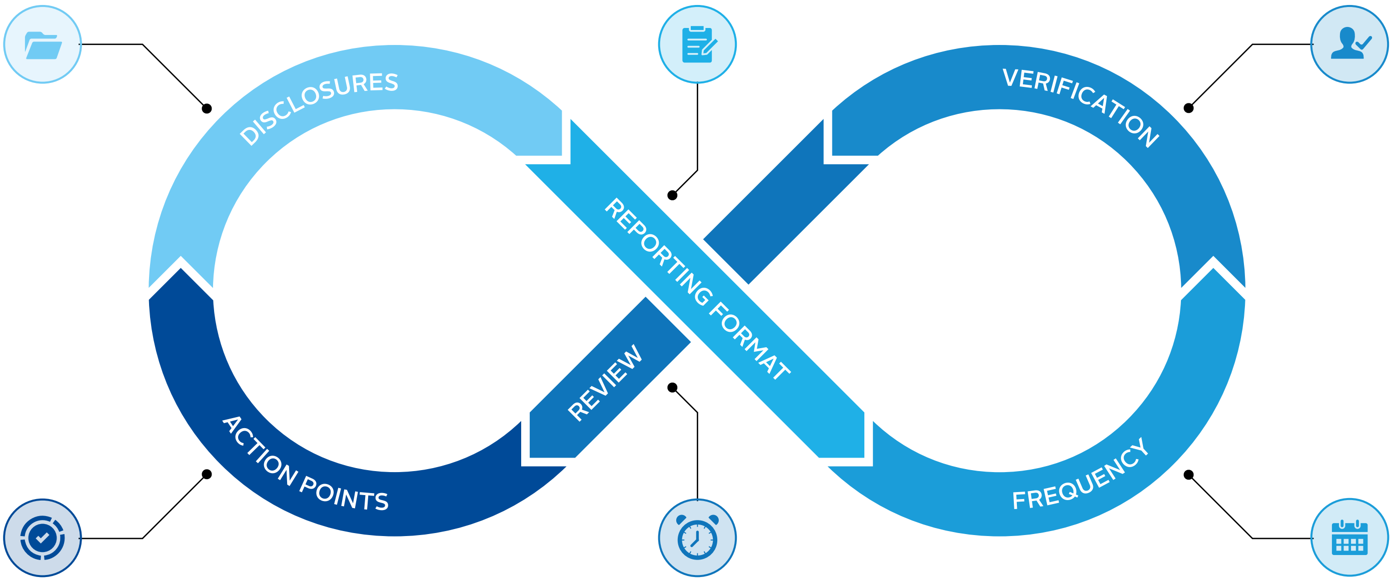
The adoption of the leading practices identified within this guide is not limited to PRI signatories but is applicable to the industry as a whole, independent of fund structure. The disclosures included in this guide reflect current industry practice. The PRI anticipates updating this guide in future as market practice evolves.

1 In addition, the PRI reviewed signatory responses to the 2020 PRI's Reporting and Assessment Framework as a sense check. This group was comprised of 661 reporting entities, including 381 asset owner organisations.

MODULE 5: ASSET OWNER – MANAGER MONITORING

This guide provides a framework of tools and practical recommendations for asset owners to monitor an investment manager's ESG investment approach, strategy and performance (see Figure 3). These tools and recommendations can be tailored to fit the asset owner's existing or developing approach to investment manager monitoring.

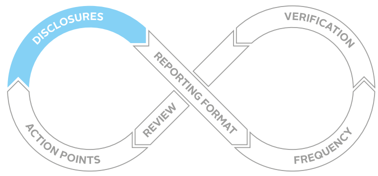
Figure 3: The investment manager monitoring process



The specifics of what should be reported, and how frequently reporting should take place, should be agreed between the asset owner and the investment manager during the appointment phase. The legal documentation in the investment management agreement (IMA) and supplemental items are the foundation for a successful manager-asset owner relationship and predefine the steps suggested in this guide.

It will require time, resources and expertise to review and assess the reported information. The review and assessment should be completed on a regular basis, whether quarterly, semi-annually or annually. It should inform strategic investment manager monitoring, allow for peer investment manager comparisons and support reporting to clients and beneficiaries.

Investment manager monitoring is an iterative process between the asset owner and investment manager to promote disclosure, discussion and improvement of ESG incorporation, stewardship and outcomes.



DISCLOSURES

This section covers the recommended disclosures for the investment manager. The suggested reporting is structured at the firm, fund, asset class, stewardship and outcomes level.

The reporting disclosures provides the foundation of the monitoring process. They are key to reviewing and assessing the quality of investment manager activities during the investment period. This section suggests monitoring disclosures, grouped at the firm, fund, asset class, stewardship and outcomes level. Some disclosures may only be applicable to certain asset classes, with suggestions indicated in the tables below. Disclosures include information to enable the asset owner to judge whether an investment manager is meeting its responsible investment objectives and fiduciary duties, and whether it is minimising negative outcomes and maximising positive outcomes. Even though the asset owner can choose which disclosures are reported, using a set of consistent and standardised disclosures helps comparability across investment managers, asset class and themes or practices.

The asset owner may also have specific objectives or goals that can be developed into additional disclosures to understand progress in these areas. Disclosures should help asset owners identify potential 'style drift' away from a chosen investment strategy.

The disclosures within this guide can provide detailed manager information that is similar, but with more detail, to that submitted to the annual PRI Reporting and Assessment Framework. The disclosures suggested below, and the PRI Reporting and Assessment Framework, can be used to provide a full representation of the investment manager's responsible investment activities.

When agreeing the information to be disclosed, the asset owner should consider the following reporting quality criteria. The information should be:

- ✓ **Accurate and credible**
- ✓ **Balanced and objective**
- ✓ **Clear and understandable**
- ✓ **Comparable and consistent**
- ✓ **Complete and material**
- ✓ **Reliable and verifiable**
- ✓ **Timely and regular**

The disclosures are categorised by firm, fund, asset class, stewardship and outcomes level to provide the building blocks for developing an investment manager reporting framework; however, not all disclosures may apply. The disclosure tools can either provide a base upon which to build investment manager reporting requirements or be additional disclosures for existing reporting requirements. Recommended practice would involve a review of the disclosure tools compared with current reporting, with the intent to enhance the reported information and associated review. Disclosures at the firm and fund level are applicable across all managers and asset classes. Table 1 provides specific questions at asset class, stewardship and outcomes level.

The disclosures, supported by the private responses from the PRI Reporting and Assessment Framework, should provide the asset owner with sufficient information on the performance and actions of the investment manager to determine alignment with responsible investment policy and strategy. The reporting format, content and frequency should be outlined in the legal documents between the asset owner and the investment manager.

The disclosed information may also be used by the asset owner to report back to its clients and beneficiaries to demonstrate how its responsible investment performance is meeting its objectives. Further, the asset owner may already have an internal database that contains historic disclosure records from ongoing monitoring activities. This resource may help shape and refine the monitoring process to reflect ESG performance, as highlighted in the Investment Manager Selection Guide.

BOX 2: DISCLOSURE RESOURCES

The disclosure framework and reporting criteria in this guide draws on insights and specific information from the following resources:

- The Financial Reporting Council's UK Stewardship Code;
- The PRI's Reporting and Assessment Framework, specifically the Asset Owners' Selection, Appointment and Monitoring responses and information;
- The PRI's responsible investment due diligence questionnaires for real estate investors, forestry investors, farmland investors, private debt investors, infrastructure investors, hedge fund investors and private equity investors;
- The PRI's A practical guide to ESG integration for equity investing;
- The PRI's ESG monitoring, reporting and dialogue in private equity;
- The PRI Leaders' Group 2019 report;
- The PRI's Investing with SDG Outcomes: A five-part framework;
- The PRI's An introduction to responsible investment: Climate change;
- Feedback from asset owner signatories;
- The Global Reporting Initiative Standards;
- The Sustainability Accounting Standards Board Standards; and
- The recommendations of the Task Force on Climate-Related Financial Disclosures.

HOW TO USE THE DISCLOSURES TOOL

The disclosures tool below is intended as guidance for reporting, rather than as a comply-or-explain framework, and to encourage a consistent industry approach towards manager monitoring. The disclosures describe what information should be reported. They are based on the sources listed in Box 2 and are aligned with the PRI due diligence questionnaires.

Table 1: Monitoring disclosures tool

FIRM LEVEL	LISTED EQUITY	FIXED INCOME[2]	ALTERNATIVES[3]
Responsible investment policy			
▪ What responsible investment policy updates have been made in the reporting period?		APPLICABLE THROUGHOUT	
Governance			
▪ Has responsible investment resourcing and oversight at the organisation changed in the reporting period? If so, detail changes. ▪ Detail any staff training and compensation link to responsible investment.			
Process developments			
▪ Has the overall responsible investment process changed or been developed in the reporting period?			

FUND LEVEL	LISTED EQUITY	FIXED INCOME	ALTERNATIVES
Asset owner responsible investment strategy alignment			
▪ Provide details on how you are currently aligned with the asset owner's responsible investment strategy and where there are further implementation measures required to become aligned.		APPLICABLE THROUGHOUT	
ESG data			
▪ What ESG data, rating agencies, research, third-party consultants, certification schemes and tools have been used? ▪ What proportion/percentage of the portfolio is covered by this ESG information?			
▪ To what extent are your investments EU Taxonomy-compliant?			

2 PRI's private debt programme falls under fixed income.

3 The term alternatives includes investments such as private equity, hedge funds, infrastructure, real estate, farmland and forestry.

FUND LEVEL	LISTED EQUITY	FIXED INCOME	ALTERNATIVES
ESG risk management			
▪ What updates or changes have been made to the ESG risk management process during the reporting period?			
▪ Explain changes in the reporting period for: ▪ Seeking amendments to terms and conditions in indentures or contracts; ▪ Seeking access to information provided in trust deeds; ▪ Impairment rights; and ▪ Reviewing prospectus and transaction documents.			
▪ Provide at least one positive and one negative example of how ESG factors have impacted investment decisions.			
ESG risks and opportunities			
▪ Provide at least one, and up to three, example(s) of major ESG risks that you identified in your holdings over the reporting period, and what has been done to mitigate them.			
▪ Provide at least one, and up to three, example(s) of major ESG opportunities that you identified in your holdings over the reporting period.			
Material incidents			
▪ Provide a detailed record of material ESG incidents from the last reporting cycle. ▪ As a result of material incidents, why did you increase, maintain or decrease particular holdings?			
Performance targets			
▪ Disclose any material ESG developments regarding and progress towards portfolio companies' specific targets in the portfolio. ▪ Disclose whether portfolio companies are on target, exceeding or underperforming their ESG targets.			
▪ Provide information about any changes made to your performance benchmark with respect to responsible investment.			

APPLICABLE THROUGHOUT

ASSET CLASS LEVEL	LISTED EQUITY	FIXED INCOME	PRIVATE EQUITY	HEDGE FUNDS	INFRASTRUCTURE	REAL ESTATE	FARMLAND	FORESTRY
Portfolio composition								
▪ Explain how ESG incorporation has impacted portfolio composition.	✓	✓	✓	✓	✓	✓	✓	✓
▪ Provide the percentage of the portfolio which has been evaluated for ESG performance.	✓	✓	✓	✓	✓		✓	✓
▪ Provide specific examples of ESG factors contributing to buy and sell decisions. Are there particular ESG factors you consistently consider in your portfolio?	✓	✓	✓	✓	✓			
ESG incorporation								
▪ Provide the top five and bottom five performers according to your criteria for rating ESG performance. ▪ Provide details as to why the worst ESG performers remain in your portfolio.	✓	✓	✓	✓				
ESG performance and action plans								
▪ What, if any, action plans were developed in the reporting period to improve the risk/return profile of the portfolio through material ESG factors?	✓	✓	✓	✓	✓		✓	✓
▪ Provide recent examples of ESG initiatives that the asset was already undertaking that the investment manager has identified as leading practice.			✓		✓		✓	✓
Monitoring ESG and incident response								
▪ Provide recent examples for monitoring the ESG aspects of the underlying assets and how you ensure your assets and/or third-party operator(s) respond appropriately to material ESG incidents.			✓		✓		✓	✓
▪ Provide any developments regarding and progress towards your ESG performance targets.			✓		✓		✓	✓
Exit strategy								
▪ Provide recent examples where ESG considerations were included in preparations for asset disposal (exit and post-exit phases).			✓		✓		✓	✓

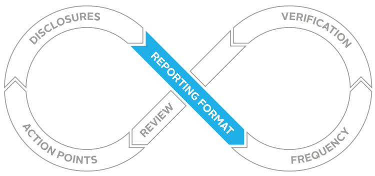
STEWARDSHIP	LISTED EQUITY	FIXED INCOME	PRIVATE EQUITY	HEDGE FUNDS	INFRASTRUCTURE	REAL ESTATE	FARMLAND	FORESTRY
Stewardship implementation and activity								
▪ Explain how you have implemented stewardship policies, including how you monitor investee companies and, for listed equities, your voting behaviour and your use of proxy advisors.	✓	✓	✓	✓	✓	✓	✓	✓
▪ Explain how ownership rights and responsibilities have been exercised on behalf of the asset owner, and how the approach has differed within and among your portfolios in the reporting period.	✓	✓		✓	✓	✓	✓	✓
Engagement								
▪ What changes have you implemented to your engagement process during the reporting period?	✓	✓	✓	✓	✓	✓	✓	✓
▪ Provide at least one and up to three specific example(s) of engagement and how it has been used to monitor organisations (intentions, success or failure results, contribution to portfolio risk or return, escalation, etc).	✓	✓	✓	✓	✓	✓	✓	✓
▪ Provide a list of examples of how results of engagement have informed investment decisions.	✓	✓	✓	✓	✓	✓	✓	✓
▪ Provide details of key collaborative engagement initiatives in the reporting period (details of desired change or issue, method of collaboration, role and contribution, etc.).	✓	✓		✓				
▪ Provide examples of successes contributed to within collaborative engagements. Describe your role and how the results of engagements have informed investment decisions.	✓	✓		✓				
▪ Provide details of how you have measured the success of engagements. Is it quantifiable? If not, what were the qualitative results?	✓	✓	✓	✓				
▪ Provide details of how portfolio managers have been involved in active ownership activities in the reporting period.	✓	✓	✓	✓	✓		✓	✓
▪ Provide details of engagements on ESG issues that you or a third party have had with portfolio holdings, other investors or local communities. If completed, what areas and activities were typically part of the engagements?			✓			✓	✓	✓

STEWARDSHIP	LISTED EQUITY	FIXED INCOME	PRIVATE EQUITY	HEDGE FUNDS	INFRASTRUCTURE	REAL ESTATE	FARMLAND	FORESTRY
Voting								
▪ Disclose any changes in policies or processes that have taken place in the reporting period for voting (scope, resources).	✓			✓				
▪ Provide some specific results of proxy voting activities and decisions (e.g. follow up, any prior engagement activity, rationale, the percentage reviewed in-house, management of conflicts of interest and any deviations from policy).	✓			✓				
▪ Provide any changes or deviations in the reporting period to stock-lending policies, details of events where holdings (entire or partial) could not be voted due to stock on loan over record date, and any instances where lent stock was recalled for voting.	✓			✓				
▪ Provide details on outcomes of any voting audit and extent of audit - which checks whether votes were cast as intended and reached the company; results for key votes against the portfolio manager's assessment/vote cast.	✓			✓				
▪ Provide examples of the results of resolutions voted on in the reporting period.	✓			✓				
▪ Provide the proportion of shares voted in the reporting period (if less than 100%, specify and provide reasons for missed/failed votes).	✓			✓				
▪ Provide a breakdown of votes cast against management and abstentions.	✓			✓				
▪ Provide the rationale for some or all voting decisions in the reporting period, particularly where: there was a vote against the board; there were votes against shareholder resolutions; a vote was withheld; or the vote was not in line with voting policy.	✓			✓				

OUTCOMES	LISTED EQUITY	FIXED INCOME	PRIVATE EQUITY	HEDGE FUNDS	INFRASTRUCTURE	REAL ESTATE	FARMLAND	FORESTRY
Climate change (as per TCFD Recommendations)								
Climate change governance								
■ Provide details for the reporting period of how you have voted or engaged with companies to address climate change.								
■ Describe any change in the board's oversight of climate-related risks and opportunities.								
■ Describe management's role in assessing and managing climate-related risks and opportunities.								
Climate change strategy								
■ Describe the climate-related risks and opportunities that have been identified over the short, medium and long term, as determined in the reporting period.								
■ Describe how climate-related risks and opportunities are factored into relevant product or investment strategies in the reporting period. Include information on how each product or investment strategy might be affected by the transition to a lower-carbon economy.			APPLICABLE THROUGHOUT					
■ Describe the resilience of your strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario, as determined in the reporting period.								
Climate change risk management								
■ Describe any change (positive or negative) in how processes for identifying, assessing and managing climate-related risks have been integrated into the organisation's overall risk management in the reporting period.								

OUTCOMES	LISTED EQUITY	FIXED INCOME	PRIVATE EQUITY	HEDGE FUNDS	INFRASTRUCTURE	REAL ESTATE	FARMLAND	FORESTRY
Climate change metrics and targets								
▪ Disclose the metrics used to assess climate-related risks and opportunities in line with strategy and risk management process for each product or investment strategy in the reporting period. Also describe how these metrics have changed over time.	✓	✓	✓	✓	✓	✓	✓	✓
▪ Disclose Scope 1, Scope 2 and, if appropriate, Scope 3 greenhouse gas emissions, disclosed as weighted average carbon intensity, where data are available or can be reasonably estimated, for each product or investment strategy.	✓	✓	✓	✓	✓	✓	✓	✓
▪ Describe the targets used to manage climate-related risks and opportunities and performance against targets.	✓	✓	✓	✓	✓	✓	✓	✓
Sustainable Development Goals								
▪ Provide at least one and up to three specific example(s) of positive and/or negative outcomes from your investment activities (investment decisions and tools of influence) for the reporting period.	✓	✓	✓	✓	✓	✓	✓	✓
▪ Provide at least one and up to three specific example(s) of how you have implemented any policies on shaping outcomes in line with the SDGs (ie. policies with the goal of increasing positive outcomes/decreasing negative outcomes) for the reporting period.	✓	✓	✓	✓	✓	✓	✓	✓
▪ Disclose if and how your organisation's investment professionals have implemented formal responsibilities in the reporting period for outcome objectives as part of their 1) personal objectives 2) appraisal process 3) incentives 4) training.	✓	✓	✓	✓	✓	✓	✓	✓
▪ Provide details of any specific outcomes or objectives in your investment activities set in the reporting period (for increasing positive outcomes and/or decreasing negative outcomes). ▪ For each outcome objective (set previously or during the reporting period), provide details on progress.	✓	✓	✓	✓	✓	✓	✓	✓
▪ Provide details of if or how voting or engagement objectives have sought to improve real-world outcomes.	✓		✓	✓				

Note: Examples for outcomes questions should be balanced and include instances where the desired outcome has not been achieved or is yet to be achieved. The suggested disclosures are adapted from PRI and third-party resources. For further information on outcomes, see the PRI report Investing with SDG Outcomes: A five-part framework

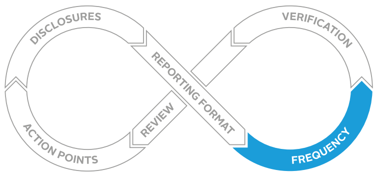


REPORTING FORMAT

This section sets out how reported information should be collected and collated by the asset owner.

Expectations regarding the format and detail of reporting should be agreed by the asset owner and investment manager. Ideally, the format should be consistent across similar investment managers to enable analysis, comparability and ease of use. To facilitate analysis, the asset owner may require the information to be submitted electronically directly into the asset owner's systems.

The information should be maintained by the asset owner to enable internal learning on effective investment manager supervision as well as to support future selection processes. The accumulated database may help inform the selection process, as noted in Investment Manager Selection Guide.



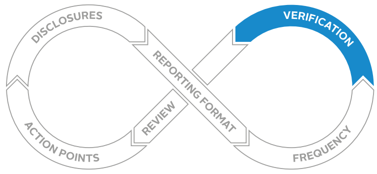
FREQUENCY

This section considers how often information should be provided and the terms for incident reporting.

Regular reporting is important for the asset owner to maintain understanding of the investment manager's activities. Regular monitoring typically improves performance, as under-performing areas can be addressed and issues raised sooner rather than later.

The frequency of reporting depends on the needs of the asset owner as well as the type of disclosures involved. Some disclosures may require greater frequency or may be triggered as the result of an incident. Reporting frequency, whether on an annual (at the minimum), quarterly, monthly or ad hoc basis, should be agreed between the asset owner and investment manager and signed off for the various disclosures.

Certain ad hoc reporting should be mandated when a significant event occurs. A significant event is one that could affect the underlying value, resultant outcomes or reputation of those involved, meaning that the asset owner would need to be notified immediately. The definition of 'significant event' needs to be agreed by the asset owner and investment manager so that reporting expectations are clear. Investment Manager Appointment Guide provides tools and clauses to incorporate language around reporting in the legal documentation.



VERIFICATION

This section covers the internal assurance process used by the investment manager to provide adequate and verified information to the asset owner. It also discusses the possible use of third-party external verification and audit models.

The investment manager's governing body accountable for policy implementation should specify the level of internal sign-off or third-party verification required for the information reported to the asset owner. A thorough document trail should exist for all reported information, enabling the sourcing of further information if required.

The information should be maintained in such a manner that allows for auditing and verification of the reported information. Figure 4 depicts some of the levels of auditing and assurance that investment managers could apply.

Figure 4: Investment manager reporting ESG audit and assurance. Source: PRI (2018), [Introducing confidence-building measures to PRI signatories].

Internal control system	Internal audit of control system	External third-party assurance (To be undertaken every two or three years)
▪ Ongoing controls for the collection and preparation of ESG information ▪ Gives internal confidence ▪ Pre-requisite for internal audit	▪ Helps achieve organisational objectives, including ESG reporting goals ▪ Identifies risks and opportunities for management ▪ From three-five years of controls for ESG reporting	▪ Provides the highest form of impartial assurance ▪ Assurance over ESG data and/or processes ▪ Every two-three years ▪ Processes would be assured every five years under Chartered institute of Internal Auditors standards as part of internal audit plan
Allocation of responsibilities for implementing the confidence-building measures: The three lines of defence model		
First and second line of defence: Front line operations, management, compliance/risk team	**Third line of defence:** Internal audit team or outsourced internal auditor	**External/independent third party**

According to analysis of the PRI's Reporting and Assessment Framework, third-party ESG integrated audits are regarded as the most challenging for PRI signatories. Of the 1,331 investment managers who reported in 2019 on their assurance of ESG practices, just 3.7% used third-party auditors for data points subsequently used in PRI reporting responses. Conversely, 80% of managers reportedly carried out internal verification of responses before submission to the PRI (e.g. by the CEO or the board).

REVIEW

This section provides suggestions for the systematic review of the reported information and subsequent engagement with the investment manager. This review includes data analysis, investment manager assessment, the re-evaluation of targets and investment manager benchmarking and peer review.

Figure 5 provides an overview of the investment manager review process. The review process begins once the investment manager discloses the required information to the asset owner. An annual review of the PRI Reporting and Assessment private reports should also be part of the process.

Figure 5: Investment manager review process

An asset owner may construct and utilise a monitoring tool or database that is able to review and assess (qualitatively and quantitatively) its investment managers on the various dimensions as reported for each asset class. It could also be used to check for alignment with the asset owner's responsible investment policy and/or against any minimum requirements set.

The asset owner may also consider regular internal meetings to allow cross-asset class and peer review analysis of ESG themes.

The systematic assessment of the investment manager is based on key performance indicators (KPIs, either quantitative or qualitative) relevant to the chosen disclosures. This process may involve the use of scorecards along with information received via third parties, examples of which can be found in Investment Manager Selection Guide.

The review of the reported information will provide discussion points for clarification with the manager. Discussions should include details of actual performance expectations, how responsible investment practices can be improved, current industry best practices and, if available, the results of the PRI Reporting and Assessment Framework reports. These meetings are an opportunity for both asset owners and investment managers to learn, educate, collaborate and ultimately improve responsible investment practices.

Regularly scheduled and ad hoc meetings should take place to discuss and analyse the results of any targets or goals, and to understand if the investment manager is meeting, failing or exceeding certain objectives.

Table 2 gives an example of an aggregated dashboard that includes internal monitoring assessments and third-party scores to support manager performance analysis. Qualitative and quantitative assessment criteria help categorise managers in sub-groups and enable benchmarking. A benchmark helps to rate investment managers and set minimum standards that the managers must meet. This will enable the identification of strong performers, assist in comparison between peer investment managers and help identify those that need to improve their ESG incorporation and stewardship practices. The information will also help to show progress and trend analysis over time.

Table 2: Sample aggregated dashboard for manager monitoring. Source: PRI, for illustrative purposes only.

INVESTMENT MANAGER DATA INTEGRATION					
Investment manager	**Total ESG score (weighted %)**	**Momentum***	**Third-party score****	**Monitoring assessment**	**Category**
Manager 1	100	↑	A	Positive	Leading
Manager 2	100	←→	A	Positive	Leading
Manager 3	95	↑	B+	Positive	Leading
Manager 4	87	↓	B+	Neutral	Leading
Manager 5	85	←→	B	Neutral	Midfield
Manager 6	75	←→	C+	Positive	Midfield
Manager 7	68	↓	C	Neutral	Midfield
Manager 8	55	↑	B	Positive	Midfield
Manager 9	46	↓	C	Negative	Midfield
Manager 10	30	↓	C+	Neutral	Midfield
Manager 11	27	←→	C	Neutral	Midfield
Manager 12	27	↓	D	Positive	Beginners
Manager 13	19	←→	D	Neutral	Beginners
Manager 14	12	←→	D	Neutral	Beginners
Manager 15	8	←→	D	Negative	Beginners

* Momentum sign indicates trend of internal ESG score
** Third-party score scaled numerically, rescaling needed for weighting purposes

BOX 3: THE PRI FRAMEWORK IN PRACTICE

The PRI's Reporting and Assessment Framework is a tool frequently used for investment manager monitoring. During an asset owner workshop at the 2019 PRI in Person conference, 44% of asset owners polled said that they used the framework for manager monitoring.

The PRI Data Portal provides access to information on signatory responses concerning ESG processes and performance. Asset owners can use the portal to:

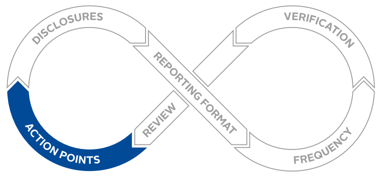
- Search for organisations and access or request available reports. Add organisations to lists you created
- View the transparency and assessment reports of your organisation
- Create and manage your lists. Request access and view reports through your lists
- Export signatories' public responses to the PRI reporting framework

In addition to publicly available Reporting and Assessment reports, asset owners can request access to private Transparency and Assessment reports. Data Portal requests to share these are approved in 60% of all cases.

Transparency reports provide the detail of the most recent signatory responses to the Reporting and Assessment framework. The Assessment report provides the PRI scores determined as a result of the signatory's responses. Those can provide a baseline for review and analysis and allow for investment manager comparisons.

Signatories can also extract detailed reported information in an aggregated form on specific areas of interest. An asset owner could, for example, download all publicly disclosed investment manager responses to the PRI's listed equity ESG integration module, or create lists of managers for advanced data analysis.

Regularly updated analysis of how signatories are utilising the tool can be found here.



ACTION POINTS

This section covers action areas for improvement, engagement and escalation as a result of monitoring activities.

Insufficient or inadequate reporting or performance, or violations of policies (see Box 4: Examples of serious violations), will require remedial action. Equally, reviews and discussions with the investment manager may identify areas where improvement or change is necessary. The review may identify managers who are failing, meeting or exceeding minimum expectations or certain KPIs.

It may lead to various action points, depending on the outcomes of the review process. Actions that could be considered, in association with open dialogue, on any non-conformances are shown in Figure 6.

Figure 6: Potential areas for improvement, engagement and escalation

AREAS FOR IMPROVEMENT

- Address any outlying risks or opportunities.
- Improve ESG analysis and integration prior to investment, follow-up or through investment period.
- Improve ESG incorporation and stewardship activities and reporting.
- Set and revaluate material ESG targets

ENGAGEMENT

- Full engagement and discussion regarding non-conforming areas.
- Develop action plans and objectives (or targets) for improving non-conforming areas.
- Change/increase reporting frequency to address non-conformances, until requirements are met.
- Define remedial actions and conditions for escalation or divestment

ESCALATION

- Notify investment manager about placement on a watch list.
- Take action through escalation with the asset owner board, investment committee or the investment manager's board of directors.
- Explain reasoning to the investment manager about the termination of contracts if failings have persisted over a (notified) period of time.
- Take action by reducing exposure to the investment manager until any non-conformances have been rectified.

BOX 4: EXAMPLES OF SERIOUS VIOLATIONS

Serious violations examples include, but are not limited to:

- Fraud
- Market manipulation
- Bribery
- Corruption
- Ethical misconduct
- Breach of OECD Guidelines for Multinational Enterprises
- Responsible investment controversies (for example investing in controversial companies or countries)
- Investing despite knowing that the investment will have a severe adverse ESG impact.
- Activities which are in breach of a stated responsible investment or ESG policy (for example investing in tobacco producers).

Source: Grant & Eisenhofer and PRI (2020)

As previously noted, investment manager monitoring is an iterative and ongoing process. All steps presented in this guide will require adjusting to the asset owner's needs and stage of advancement.

Applying the PRI's guidance should help prepare asset owners to engage in systematic manager selection, appointment and monitoring. To ensure that investment managers have the right ESG capabilities in place throughout the investment phase, asset owners should address the steps covered in this guide, adjusted for their own needs.

Continue exploring the PRI's asset owner programme

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The Principles for Responsible Investment (PRI)

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

More information: www.unpri.org

PRI Principles for Responsible Investment

The PRI is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact.

United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: www.unepfi.org

UNEP FINANCE INITIATIVE

United Nations Global Compact

The United Nations Global Compact is a call to companies everywhere to align their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to take action in support of UN goals and issues embodied in the Sustainable Development Goals. The UN Global Compact is a leadership platform for the development, implementation and disclosure of responsible corporate practices. Launched in 2000, it is the largest corporate sustainability initiative in the world, with more than 8,800 companies and 4,000 non-business signatories based in over 160 countries, and more than 80 Local Networks.

More information: www.unglobalcompact.org

United Nations Global Compact