



A LEGAL FRAMEWORK FOR IMPACT

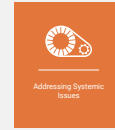
Key messages

- Sustainability outcomes are highly relevant for most investors. Negative sustainability outcomes pose significant risks to the natural and social systems on which economic prosperity and investment returns ultimately depend.
- Investors generally have a legal obligation to consider pursuing sustainability impact goals where that can help pursue their financial objectives.
- Regulators and policy makers are implementing measures to increase the incentives and ability of investors to monitor and disclose sustainability outcomes, mitigate sustainability risks, and contribute to sustainability goals.
- Member States should consider how investors can play their full role in addressing sustainability challenges posed by the economic transition. Measured and effective financial regulation reforms enable investors to contribute effectively to addressing core sustainability aspects of the economic transition.
- Policy makers should continue to clarify legal duties where necessary, while shifting the emphasis decisively to policies that support and incentivize investor action. This means:
 - ensuring investors can confidently set and pursue commitments to achieve positive sustainability outcomes;
 - establishing compatible national and regional sustainable finance policy regimes with multilateral support; and
 - developing market infrastructure (disclosures, product standards, data and incentives) to enable investors to innovate and scale up investments that contribute to sustainability goals in support of economic transition.

Key challenges

ESG integration alone is insufficient to fully mitigate risks and achieve global sustainability goals. Many governments are seeking to help investors put capital to work addressing crises like climate change. However, despite

RELEVANT ACTION AREAS



ABOUT THIS SERIES

The Financing Policy Brief Series has been prepared by the Inter-agency Task Force on Financing for Development to inform the substantive preparations for the Fourth International Conference on Financing for Development (FfD4), to be held in Sevilla, Spain, from 30 June to 3 July 2025.

The Inter-agency Task Force on Financing for Development is comprised of more than 60 United Nations Agencies and international organizations. The policy briefs in this series were not subject to review by Task Force Members, and represent the views of the authoring organizations.

The full series is available at:
<https://financing.desa.un.org/iatf/report/financing-policy-brief-series>

MORE ABOUT THIS TOPIC

This briefing is part of the Financing Policy Brief Series developed by PRI and other members of the Inter-agency Task Force on Financing for Development. The objective of the briefing is to inform the substantive preparations for the Fourth Conference on Financing for Development (FfD4). It addresses two action areas of the Addis Ababa Action Agenda (the outcome document of FfD3): 1) domestic and international private business and finance; and 2) systemic issues.

This briefing is an excerpt from the PRI, UNEP FI, and Generation Foundation 2024 summary report, *A Legal Framework for Impact: Long Term Value Creation in a Changing World*.



increasing commitments from investors, companies, and governments, the world is not on track to achieve global sustainability goals, including those set out in the Paris Agreement¹ and the Sustainable Development Goals.² Consequently, investment portfolios remain exposed to sustainability risks – including system-level risks.

There is a continuous feedback cycle between the decisions taken by investors, the sustainability outcomes to which those decisions contribute (via the behaviour of investee enterprises), whether intended or not, and the ESG risks and sustainability opportunities that affect the financial performance of investments. Negative sustainability outcomes are drivers of both risks for individual companies and sectors, and market-wide or system-level risks that affect whole portfolios. These risks can be relevant over the near, medium and long term. Conversely, investor activity can contribute to positive real-world outcomes on issues such as climate change, biodiversity, sustainable development and human rights.

As part of their responsibilities to clients and beneficiaries, investors may need to assess the real-world sustainability outcomes to which investment decisions and ownership activities can contribute and consider how these outcomes affect the system-level risks to which their portfolio is exposed.³ This is especially true for so-called universal owners, who invest across entire economies, although diversification means that most investors are systemically exposed to some degree.⁴ Institutional investors are generally tasked with securing financial returns over the long term, which tends to increase exposure to system-level risks.

System-level risks that involve economy-wide effects cannot be mitigated by traditional asset class-based diversification. The role of investors in helping to address these non-diversifiable risks is sometimes overlooked, even where ESG factors are incorporated into investment decisions in other ways. Narrow ESG integration does

not aim to resolve non-diversifiable risks that stem from system-wide issues.

To address the drivers of sustainability-related system-level risks, investors may need to take steps to increase the positive impacts of their investment activities and decrease or eliminate the negative impacts. They might do this by investing increasingly in enterprises that produce positive sustainability impacts and/or by using stewardship to encourage enterprises in their portfolio to address material issues arising from their operations.

The findings of PRI's Legal Framework for Impact report identified a range of factors that may prevent or deter investors from investing for sustainability impact, including:

- **Legal rules**
 - limits arising from narrow interpretation of legal rules on investors' powers and duties; and
 - a lack of clarity or understanding about what the law requires or permits.
- **Market structure and practice**
 - a lack of 'market infrastructure' for impact goal setting and assessment, including investee companies' disclosure obligations;
 - market features (e.g. the dominance of Modern Portfolio Theory, reliance on benchmarks and the prioritisation of short-term performance) that may lead to sustainability factors being underweighted or overlooked; and
 - perceived and actual impediments to collective action.⁵
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1. IPCC (2023), [AR6 Synthesis Report: Climate Change 2023](#).

2. UN DESA (2023), [The Sustainable Development Goals Report 2023: Special Edition](#).

3. PRI, UNEP FI, Generation Foundation (2021), [A Legal Framework for Impact](#).

4. Quigley, E. (2020), [Universal Ownership in the Age of COVID-19: Social Norms, Feedback Loops, and the Double Hermeneutic](#); PRI (2010), [Universal Ownership: Why Environmental Externalities Matter to Institutional Investors](#).

5. PRI, UNEP FI, Generation Foundation (2021), [A Legal Framework for Impact](#).



Policy solutions

Policy makers have an important role to play in supporting investors to serve their clients and beneficiaries' financial goals by overcoming barriers to greater action to pursue impact. In doing so, policy makers help mitigate system-level risks which not only protects investment value, but also advances sustainable development.

To overcome the legal and market obstacles noted above, policy makers should consider implementing reforms to address sustainability outcomes coherently across relevant regimes (rather than isolated interventions), including in the following priority areas. Policy makers should:

- **Clarify investors' existing legal duties by**
 - updating standards and guidance to clarify when investors' legal duties permit or require them to take into account sustainability outcomes and/or pursue sustainability impact goals;
 - updating standards and guidance to clarify that purpose-related requirements (sometimes described as a duty to act in the best interests of clients or beneficiaries) may entail consideration of sustainability impact goals; and
 - exploring ways to enable investors to take client and beneficiary sustainability preferences into account in their asset allocation and stewardship activities.
- **Ensure sustainable finance policies address sustainability outcomes by**
 - adopting comprehensive corporate sustainability disclosure frameworks which meet the needs of investors seeking to understand material sustainability risks, opportunities, and impacts;
 - supporting efforts to develop international standards and norms for sustainability data and reporting, and aligning national regimes with emerging global standards;
 - ensuring that sustainability disclosure and labelling regulations for investors address not only integration of ESG risks, but also how investment entities and products assess sustainability outcomes, set sustainability impact goals, and

take steps to contribute to positive sustainability impacts;

- creating and implementing sustainable taxonomies to help investors understand and promote economic activities that are environmentally and socially sustainable;
- strengthening regulatory support for effective and accountable stewardship, including for using stewardship powers to address sustainability risks and sustainability impacts;
- supporting collaborative action by investors seeking to improve sustainability outcomes, by providing regulatory guidance to ensure that sustainability-related collective action by investors does not fall foul of competition rules; and
- establishing proportionate and practicable corporate and investor due diligence requirements to ensure that negative sustainability impacts are identified and addressed, ensuring coherence with international standards including the UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises.

Progress needs to be maintained across all these policy reform areas. However, the following priorities for future policy interventions are particularly important. Governments should:

- **spell out the need for investors to consider the effects of real-world sustainability outcomes on investment performance, and consider if and how an investor can or should take appropriate action to pursue sustainability outcome objectives;**
- **ensure that corporate and investor disclosures distinguish between the effects of ESG factors on financial performance and the effects of investment activities on real-world sustainability outcomes;**
- **ensure sustainable finance policies are clear, coherent, and comprehensive, including in how they define and regulate investments that seek to achieve a sustainability outcome objective; and**
- **increase the focus on stewardship, including stewardship activities for systemic issues and sustainability outcomes.**



🌸 Specific recommendations for FFD4

FfD4 has the potential to establish clear, effective, and complementary approaches for Member States, the private sector, including the financial sector, and multilateral development banks to take in fulfilling a shared commitment to greater action in support of the global sustainability goals.

The international community is aware of the important role investors have in supporting sustainable development. Many investors support a just transition to an equitable and sustainable economy that benefits both natural and social systems. But they need Member States to create a more enabling regulatory environment at the domestic, regional, and international levels.

Member States have the opportunity to agree on an FfD4 outcome document that not only addresses the barriers to more financing for developing countries, but also the key factors that are preventing better sustainability outcomes in investments. To help investors overcome legal and market obstacles to pursuing better sustainability outcomes, Member States should agree to:

- develop and implement sustainable finance policies and regulations that ensure investors can confidently set and pursue commitments to achieve positive sustainability outcomes across all asset classes in line with their duties and obligations;
- develop and implement comprehensive corporate sustainability disclosure frameworks which meet the needs of investors seeking to understand material sustainability risks, opportunities, and impacts;
- ensure that corporate and investor disclosures distinguish between the effects of ESG factors on financial performance and the effects of investment activities on real-world sustainability outcomes;
- develop and implement sustainability disclosure and labelling regulations for investors that address integration of ESG risks, as well as how investment entities and products assess sustainability outcomes, set sustainability impact goals and take steps to contribute to positive sustainability impacts;
- develop and implement sustainable taxonomies to help investors understand and promote economic activities that are environmentally and socially sustainable;
- increase regulatory support for effective and accountable stewardship, including for using stewardship powers to address sustainability risks and sustainability impacts;
- establish proportionate and practicable corporate and investor due diligence requirements to ensure that negative sustainability impacts are identified and addressed, in line with the UN Guiding Principles on Business and Human Rights and the OECD Guidelines on Multinational Enterprises;
- support collaborative action by investors seeking to improve sustainability outcomes, by providing regulatory guidance to ensure that sustainability-related collective action by investors does not fall foul of competition rules;
- ensure national and regional sustainable finance policy regimes are compatible; and
- support efforts to develop international standards for sustainability data and reporting, and align national regimes with these standards.