FIDUCIARY DUTY IN THE 21ST CENTURY
What is Responsible Investment?

**PERFORMANCE**

Not Philanthropy

“The high-sustainability companies dramatically outperformed the low-sustainability ones in terms of both stock market and accounting measures.”

Harvard Business School

**RETURNS**

Not Sacrifice

“There are statistically significant positive abnormal returns associated with going long good corporate governance firms and shorting those with poor governance.”

Yale School of Management

**RISK MANAGEMENT**

“Failing to consider long-term investment value drivers, which include ESG issues, in investment practice is a failure of fiduciary duty.”

PRI, UNEP FI Fiduciary Duty in the 21st Century

**DIVERSE APPROACHES**

Not Just Excluding Unethical Investments

“We believe that ESG analysis should be built into the investment processes of every serious investor and into the corporate strategy of every company that cares about shareholder value.”

Deutsche Bank
What is Fiduciary Duty?

Fiduciary duties (or equivalent obligations) exist to ensure that those who manage other people’s money act in the interests of beneficiaries, rather than serving their own interests. The most important of these duties are:

- **Loyalty**: Fiduciaries should act in good faith in the interests of their beneficiaries, should impartially balance the conflicting interests of different beneficiaries, should avoid conflicts of interest and should not act for the benefit of themselves or a third party.

- **Prudence**: Fiduciaries should act with due care, skill and diligence, investing as an ‘ordinary prudent person’ would do.

There is mounting evidence that ESG issues can affect the performance of investment portfolios and have implications for a company’s earnings and prospects as well as broader economic functioning.

Richard F. Lacaille, State Street Global Advisors
Fiduciary Duty in the 21st Century

“Sustainability is an important factor in the long-term success of a business. Therefore as with any other issue related to the prudent management of capital, considering sustainability is not only important to upholding fiduciary duty, it is obligatory.”

Al Gore and David Blood, Generation IM
Fiduciary Duty in the 21st Century
Common Law vs. Civil Law

- In the common law jurisdictions, for example – Australia, Canada, South Africa, the UK, the US – fiduciary duties are articulated in statute and decided in the courts: some rules are open to re-interpretation over time or when applied to new facts.

- In the US, for example, the decision-maker’s duty is to exercise reasonable care, skill, and caution in pursuing an overall investment strategy that incorporates risk and return objectives reasonably suitable to the trust.

- In countries where civil law applies – Brazil, Germany, Japan – any obligations equivalent to ‘fiduciary duties’ will be set-out in statutory provisions regulating the conduct of investment decision-makers and in the governmental and other guidelines that assist in the interpretation of these provisions.

“The concept of fiduciary duty is organic, not static. It will continue to evolve as society changes, not least in response to the urgent need for us to move towards an environmentally, economically and socially sustainable financial system.”

Professor Paul Watchman, University of Glasgow, Fiduciary Duty in the 21st Century
Fiduciary Duty is a Process Test

- When evaluating whether or not an institutional investor has delivered on its fiduciary duties, both the outcomes achieved and the process followed are of critical importance.

- Fiduciaries need to be able to show that they have identified and assessed the risks (to companies and to their portfolios).

- In the case of climate change, for example, this would require them to:
  - Show that they have recognised relevant risks (even if they are sceptics on the issue of climate change).
  - Analyse how climate change might affect investment returns over the short, medium and long-term.
  - Explicitly manage the risks, and not assume that the risks are automatically managed by other risk management strategies.
  - Interrogate and challenge the individuals or organisations (e.g. investment managers, companies) to ensure that these risks are being effectively managed.
  - Establish processes that enable them to demonstrate the actions they have taken.
The purpose of this report is to end the debate about whether fiduciary duty is a legitimate barrier to investors integrating environmental, social and governance (ESG) issues into their investment processes.

Failing to consider long-term investment value drivers, which include environmental, social and governance issues, in investment practice is a failure of fiduciary duty.

Despite significant progress, many investors have yet to fully integrate environmental, social and governance issues into their investment decision-making processes.

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**International Challenges**

- The lack of regulatory guidance or court decisions on how responsible investment aligns with fiduciary duty.
- Legal advisers and investment consultants continuing to argue for very narrow interpretations of fiduciary duty, perhaps in part because of the lack of explicit guidance.
- The lack of robust evidence on the relationship between environmental and social issues and investment performance.
- The weaknesses and inconsistencies in corporate reporting on environmental and social issues.
- Many trustees continuing to equate responsible investment with negative screening and thereby limiting their investment universe with consequent negative effects on investment performance.
- The relatively small number of individuals with deep expertise in areas such as ESG integration and active ownership.
Global Recommendations - Intermediaries

- Advise fiduciaries that they need to analyse and take account of long-term value drivers including ESG issues.
- Support research on the relationship between ESG issues and investment performance.
- Support cultural change on ESG issues across the financial sector through training, and professional ethics requirements.
- Publish guidance on implementation processes: investment beliefs, long-term mandates, integrated reporting and performance.

“Mercer encourages all clients to take a long-term perspective (where longterm may refer to the life of the fund for pension funds or in perpetuity for certain foundations).”

Lucy Tusa, Mercer
Fiduciary Duty in the 21st Century
Global Recommendations - Institutional Investors

- Publish commitments to ESG integration and to responsible investment.
- Ensure that these commitments are implemented effectively in investment processes, and report.
- Ensure that trustees, boards and executives have the resources and knowledge to hold investment managers and advisers to account on ESG integration.
- Require companies to provide robust and detailed accounts of their management of ESG issues.
- Engage policymakers on issues relevant to long-term performance.

“As a Dutch pension fund investor APG is required to integrate ESG factors across all its asset classes and investment processes as part and parcel of what it does. It is core to our pension fund investing proposition.”

Claudia Kruse, APG
Fiduciary Duty in the 21st Century
Global Recommendations - Policymakers

- Legal and policy clarification that fiduciary duty requires investors to take account of ESG issues.
- Strengthened implementation of legislation and codes, clarifying that these refer to ESG issues.
- Clarification of the expectations of trustees’ competence and skill.
- Harmonization of legislation and policy instruments on responsible investment globally.

“The Law Commission review has made it clear that investors should do more engagement and should pay more attention to long-term investment returns / performance. The reality is that asset managers – because of their resources, capabilities – need to lead these efforts. But it does require asset owners to press them to do so.”

David Styles, FRC (UK)
Fiduciary Duty in the 21st Century
Recommendations - Canada

The Office of the Superintendent of Financial Institutions and the relevant pension regulators in each province should clarify that asset owners are expected to pay attention to long-term factors (including ESG factors) in their decision-making, and in the decision-making of their agents.

The federal government and the governments of the provinces should follow the example set by Ontario and introduce ESG disclosure legislation. The legislation should require regulators to:

- Review progress annually.
- Explain how asset owners integrate ESG issues into their investment processes.
- Analyse how these commitments have affected the actions taken and the outcomes achieved (where the outcomes relate to both investment performance and to the ESG performance of the entities in which they are invested).
Next steps

These recommendations form the basis of a three-year project, launched in January 2016, and convened by the PRI, UNEP FI and The Generation Foundation.

The project has three main components:

1. Publish and implement roadmaps on the policy changes required to achieve full integration of ESG issues in investment processes and practices.

2. Extend the research into fiduciary duties – and, more broadly, investor duties – to five major Asian markets, China (and Hong Kong), India, Korea, Malaysia and Singapore.

3. Working with investors, governments and intergovernmental organisations, to publish an international statement on investor duties, which includes the requirement to integrate ESG issues into investment processes and practices.
**Resources**


- Reuters, Sustainable Investing is a Fiduciary Duty: [http://uk.reuters.com/article/2015/09/06/uk-funds-investing-duty-idUKKCN0R610O20150906](http://uk.reuters.com/article/2015/09/06/uk-funds-investing-duty-idUKKCN0R610O20150906)

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