

# **A Fiduciary's Role in the Measurement, Management and Maintenance of *Sustainability Risk***

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# Outline

- A method to reform fiduciary duty in order to:
  - Bridge the gap between the business case and normative case for responsible/sustainable investing in order to promote sustainability

How?

- By introducing the concept of *sustainability risk*
- By providing a sustainability pedagogical framework

# Investment Relationships

## Principal/Agent Relationship

- Investor / Investment Agent or Fund Manager
- Shareholders / Management

## Trust Relationship

- Beneficiaries – Trustees Relationship

# Fiduciary

- an individual or institution responsible for *acting in the **best interests*** of another party
- bound by law, and duty to put aside personal interests and act in good faith when making decision for the benefit of another

What are the best interests of Investors /  
Shareholders / Beneficiaries?  
How do we define this?

# Investment Advisors in Canada – Standard A: Duty of Care

The *‘Know your Client Rule’* states:

“All registrants...must make a diligent and business-like effort to learn the **essential financial and personal circumstances** and the investment objectives of each client.

Documentation should reflect **all material information** about the client’s current status, and .. assure suitability of investment recommendations.”

What material information is collected to learn these circumstances?

# Investor / Investment Agent

The Material Information collected is:

1. Age
2. Income and Net Worth
3. Investment knowledge
4. Investment Objective (safety, income and growth)
5. Financial Risk Tolerance (high, moderate or low)

It is presumed that all investors want maximum financial return for the least risk at any cost to non-financial factors, leading to the business case approach to responsible investing

Are all investors expectations uniform?

# Then how do moral issues currently get addressed in Investment Relationships?

- Large Shareholders (costly, problem of small dispersed shareholders)
- Managers at times may use their discretion
- Elhauge (2005) states :  
“A corporation run by managers perfectly accountable to shareholders would be “soulless” because the corporate structure insulates shareholders from the social and moral processes that give us “soul”

# Introducing *Sustainability Risk* into Portfolio Management

Financial Risk – the exposure to the chance  
of *financial loss* in a portfolio of  
investments

Sustainability Risk – the exposure to the  
chance of loss to *non-financial* elements  
within and resulting from a portfolio of  
investments

Investor / Beneficiary / Shareholder tolerance to  
Sustainability Risk is currently assumed by Fiduciaries to  
be INFINITE

# How can fiduciaries measure sustainability risk?

Through a Sustainability Risk Survey

Define a tolerance for each investor as either:

- i. Low Sustainability Risk Tolerance
- ii. Medium Sustainability Risk Tolerance
- iii. High Sustainability Risk Tolerance

*Sustainability Risk should be measured, managed and maintained by fiduciaries*

# i) Low Sustainability Risk Tolerance

- Fiduciaries will subscribe to all Sustainable Investing Methods promoting long – term considerations, integrating ESG factors and other sustainability related Non-Financial considerations.
- Consultations on new investment opportunities should include both expected financial performance and expected non-financial performance of investments, as they relate to ESG and sustainability issues.
- Along with financial performance reports, impact assessment reports outlining the impact their investments had on ESG and sustainability related issues should be distributed to the client
- A sustainable approach to business should be promoted, so that systematic risks in the market resulting from ESG factors are reduced.

# Sustainable Investing Methods Incorporating *Sustainability Risk*

A more comprehensive understanding of the best interests of investors allows communication by fiduciaries to be more direct (ex. Management Meeting, Proxy Voting)

Has the fiduciary/agent/managers put themselves in the position of potential conflict with the sustainability risk tolerance of the beneficiaries.

# Sustainability Pedagogy

- The Politics of Pedagogy & the Pedagogy of Politics
- Fiduciaries & Investors have little training or education on sustainable investing issues or methods
- Choice Architecture, Herd Mentality, Status Quo Bias, lack of training on sustainability issues for both fiduciaries and investors, and institutional pressures support traditional investment methods

*We are in a race between education and catastrophe* -  
H.G. Wells

**PRINCIPAL LEVEL**

Retail Investors

Shareholders

Beneficiaries



Sustainability Risk Framework  $\nearrow$

Sustainable Pedagogy



Fiduciary Duty

Accountability for Externalities



**AGENT LEVEL**

Investment Funds

Corporations

Trusts

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