FIDUCIARY DUTY IN THE 21ST CENTURY

GLOBAL STATEMENT ON INVESTOR OBLIGATIONS AND DUTIES

generation foundation

UNEP FINANCE INITIATIVE

PRI Principles for Responsible Investment

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CREDITS

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STATEMENT

We believe that investors and other organisations in the investment system must:

- Act with due care, skill and diligence, in line with professional norms and standards of behaviour.
- Act in good faith in the interests of their beneficiaries and clients, including avoiding conflicts of interest, or where such conflicts are unavoidable, to balance and disclose such conflicts.
- Take account of environmental, social and governance (ESG) issues, in their investment processes and decision-making, encourage high standards of ESG performance in the companies or other entities in which they are invested, and support the stability and resilience of the financial system.

Many of these obligations and duties are already expressed in various ways under the law in different jurisdictions. However, we recognise that there are gaps and variations in both the specific obligations and duties that are placed on investors, and in the manner in which these are interpreted and implemented in each jurisdiction. We specifically note a lack of explicit mechanisms for investors to take account of ESG issues in their investment processes, in their dialogue with companies, and in their engagement with policymakers.

While many investors meet and frequently exceed these obligations and duties, we believe that effective policy can both clarify these obligations and duties and enhance the effectiveness of existing practices. This is particularly the case in relation to the adequate consideration of ESG issues in long and short-term investment decision-making.

We therefore:

- Call on international and supranational policymakers to clarify investors' obligations and duties, in particular, in relation to the integration of ESG issues into investment practice.
- Call on national policymakers to ensure that their national policies align with this clarification of investors' obligations and duties and to ensure that these policies are effectively implemented.

BACKGROUND BRIEFING

INTRODUCTION

In January 2016, the Principles for Responsible Investment (PRI), the United Nations Environment Programme Finance Initiative (UNEP FI) and The Generation Foundation launched a three year project to clarify investors' obligations and duties in relation to the integration of environmental, social and governance issues in investment practice and decision-making.

This follows the publication in September 2015 of *Fiduciary Duty in the 21st Century*[1] by the PRI, UNEP FI, UNEP Inquiry and UN Global Compact.

The project has three reinforcing components:

- Working with investors, governments and intergovernmental organisations to develop and publish an international statement on investor obligations and duties, which encourages the integration of ESG issues into investment processes and practices.
- Publishing and implementing roadmaps on the policy changes required to achieve full integration of ESG issues in investment processes and practices across eight countries (US, Canada, Germany, UK, Japan, Australia, South Africa and Brazil).
- Extending the research into fiduciary duties – and, more broadly, investor obligations and duties – to five major Asian markets: China (including Hong Kong), India, Korea, Malaysia and Singapore.

CURRENT PRACTICE ON INVESTOR OBLIGATIONS AND DUTIES

Based on in-depth assessment in eight countries (US, Canada, Germany, UK, Japan, Australia, South Africa and Brazil), *Fiduciary Duty in the 21st Century* concluded that "Failing to consider long-term investment value drivers, which include ESG issues, in investment practice is a failure of fiduciary duty". It also acknowledged that despite significant progress, many investors have yet to fully integrate ESG issues into their investment decision-making processes. The report recommended that standards of practice across the investment industry be raised in two areas:

- The integration of ESG issues into investment practices and decision-making. Despite significant progress many institutional investors do not systematically integrate ESG issues into their investment processes, and relatively few engage with the companies or entities in which they are invested. This is despite growing evidence that these are important drivers of investment performance.

- The obligations that investment organisations owe to their beneficiaries and clients. The global financial crisis demonstrated that standard investment practices were inadequate to protect clients and beneficiaries from significant financial losses resulting from systemic risks and low probability/high consequence events.

In both cases, interviewees for the *Fiduciary Duty in the 21st Century* report pointed to weaknesses in policy frameworks and to weaknesses in the interpretation and implementation of policy as barriers to progress.

1 www.unepfi.org/fileadmin/documents/fiduciary_duty_21st_century.pdf, PRI, UNEP FI, UNEP Inquiry and UN Global Compact, September 2015

THE NEED FOR POLICY CLARIFICATION

There is growing policy action on ESG issues. For example, an increasing number of countries require institutional investors to adopt and publish policies on ESG issues and to report on the implementation of these policies. Many have also introduced mandatory reporting requirements for companies, significantly improving the quantity and quality of information that is available to investors. Despite this, many countries remain hesitant to take action in this area. There are various reasons:

- The desire not to disadvantage domestic companies through the imposition of additional regulatory requirements.
- The reluctance to take a position that leads to national policy diverging significantly from international practice.
- The perception that ESG issues are not important to investment practice and performance.
- The assumption that appropriate investment behaviours flow inevitably from existing market and regulatory pressures (and do not require explicit regulatory signals).

The lack of regulatory action has been interpreted by many investors as a signal that ESG issues are not important to short and long-term investment performance, and as a signal that investors have limited responsibility for the wider social, environmental or economic consequences of their activities.

THE PURPOSE OF THE INVESTOR STATEMENT

The purpose of the investor statement is therefore to:

- Provide governments with the confidence to act, knowing that other countries are also taking action.
- Provide consistency between countries by clarifying that the duties of loyalty, prudence and competence apply to all investors across all jurisdictions and by clarifying that investors must pay attention to long-term investment value drivers, including ESG issues, in their investment processes, in their active ownership and voting activities, and in their public policy engagement.

LAUNCH AND NEXT STEPS

This statement will be launched on 29 June 2016 and it is expected to be supported by a range of investors, including asset owners, investment managers and other investment organisations.

The statement will enable the PRI and UNEP FI to work with international and supranational organisations to clarify investors' obligations and duties, and to work with national policymakers to ensure that their domestic policy frameworks align with this clarification of investors' obligations and duties.

INVESTOR FAQS

1. What is the Statement?

The Statement calls on international policymakers and national governments to clarify the obligations and duties of investors and other organisations in the investment system. It calls, specifically, for governments to clarify that investors and other organisations in the investment system must act with due care, skill and diligence, must act in good faith in the interests of their beneficiaries and clients, and must take account of environmental, social and governance issues in their investment processes and in their engagement with the companies and issuers in which they invest.

The Statement is a sign-up statement which investors can use both to frame their engagement on investor duties with policymakers and to demonstrate that this is an issue that is of real concern to investors.

For policymakers, the Statement should provide them with the confidence to clarify investors' obligations and duties, knowing that this is an agenda that is supported by investors.

2. Why do we need a Statement?

Launched in September 2015, the report, *Fiduciary Duty in the 21st Century* was based on an analysis of law, policy and investment practice in eight countries: US, Canada, Germany, UK, Japan, Australia, South Africa and Brazil. It concluded that "failing to consider long-term investment value drivers, which include ESG issues, in investment practice is a failure of fiduciary duty."

The report also noted that, despite significant progress, many investors had yet to fully integrate ESG issues into their investment decision-making processes. It pointed to a variety of reasons for this, including a lack of regulatory clarity around fiduciary duties and wider investor duties, and the reluctance of many countries to adopt measures that would lead to national policy diverging significantly from international practice.

The *Fiduciary Duty in the 21st Century* report concluded that there was a need to clarify investors' obligations and duties. This clarification would provide national governments with the confidence to act, knowing that other countries were also taking action.

3. What outcomes does the Statement seek?

The Statement is looking for:

- International and supranational policymakers to clarify investors' obligations and duties, in particular, in relation to the integration of environmental, social and governance issues into investment practice.
- National policymakers to ensure that their national policies align with this clarification of investors' obligations and duties and to ensure that these policies are effectively implemented.

4. How would this clarification relate to domestic policy?

The Statement acknowledges that the specific details of domestic policy design and implementation (e.g. whether the obligations and duties are codified or implemented through statutes, guidance, voluntary or mandatory instruments, whether specific reporting requirements are imposed on investment actors) are a matter for national policymakers and regulators. These decisions need to be made and evaluated in the context of national legal frameworks, pre-existing policy measures and approaches, and the state of development of the domestic investment markets.

We do, however, expect the clarification to encourage policymakers to monitor and report on the effectiveness of the national policies that they adopt, and to include provision for some form of assessment of, and reporting on, the aggregate impact of their policies. This will enable policymakers and other stakeholders to reflect on and learn from the actions that have been taken, and will increase the likelihood that meaningful outcomes will be delivered.

5. Why focus on investor duties and not fiduciary duties?

The obligations and duties that apply to investors differ between countries and between investors. They emerge from different sources. They may be defined in the deeds or other documents that define the purpose of the organisation, in the contracts these institutions have with their clients or beneficiaries, and at law (which, depending on the jurisdiction, could include statutes, case law, trust law, fiduciary law, corporate law or civil law concepts).

The *Fiduciary Duty in the 21st Century* report focused on fiduciary duty, which is generally recognised as a common law concept. It is also a concept whose scope of application (i.e. in terms of the investors that are considered to have fiduciary duties) differs between countries. While similar duties (e.g. loyalty, prudence) often apply in other jurisdictions and to investment actors other than those that are formally considered to be fiduciaries, these are often not defined as fiduciary duties.

In developing this Statement, we wanted to both address the gaps and variations in the specific obligations and duties that are placed on investors and to develop a set of principles that have general applicability across all jurisdictions, that can be adopted irrespective of the specific legal system in question, and that provide a common set of obligations and duties that apply to all types of investment organisations.

6. Does the requirement to focus on ESG issues mean that investors have to compromise investment returns?

The Statement is clear that the expectation is that investors will be able to demonstrate that they have taken proper account of ESG issues in their investment practices and processes. This aligns with the manner in which courts and regulators have interpreted fiduciary and equivalent obligations and duties. Courts and regulators distinguish between decision-making processes and the outcome of the decision-making process. They recognise that investment decisions inherently involve commercial risks, and so they look for investors to demonstrate that they applied an appropriate degree of diligence in their good-faith pursuit of beneficiaries' or clients' interests. They are generally reluctant to specify how investors should take account of ESG opportunities and risks in their investment practices and processes. The regulators interviewed for the *Fiduciary Duty in the 21st Century* report were clear that investors should be aware of and manage ESG-related risks, and that investors should also pay close attention to decisions that lead to skews in portfolios.

This suggests that investors must take account of wider ESG issues, so long as there is a clear focus on beneficiaries' interests. In that context, for example, a decision not to invest in coal mines (e.g. because of concerns about these assets being stranded as a result of climate change policy) is likely to be seen as consistent with investors' obligations and duties to their clients or beneficiaries, so long as this decision is based on credible assumptions and a robust decision-making process. This requires investors to have the discipline to set out their investment beliefs, to be prepared to review the investment outcomes achieved and to have the willingness to change if the data changes or if it is clear that the decision is causing significant damage to beneficiaries' or clients' financial interests.

7. What is the role of legal advisers and investment consultants?

The views held by investment consultants and legal advisers are often a key influence on the actions taken by asset owners. A recurring theme in the interviews conducted for the *Fiduciary Duty in the 21st Century* report was that the advice being given by these consultants and advisers – in particular in the US but also in other jurisdictions – is often based on a very narrow interpretation of investor duties, stressing short-term financial performance over other considerations. This advice reflects the frequent lack of legal clarity about investor duties; in the absence of clarity about whether investors should take account of ESG issues in their investment practices and processes, it is often assumed by investment consultants and legal advisers that these issues are of limited relevance to the manner in which investors operate.

8. Which organisation should host/lead the development of such an instrument?

The Statement encourages supranational organisations with binding capacity or global influence (examples include, but are not limited to the G77, the G20, the OECD, the European Union) to clarify investors' obligations and duties, in particular, in relation to the integration of environmental, social and governance issues into investment practice. The specific form of this clarification will depend on the practices and mandate of the organisation and the manner in which it articulates and implements its views and positions. For example, the clarification could be in the form of a statement, a communiqué, a guidance note, a convention or a treaty.

9. Are governments already taking action?

Yes.

This Statement is being launched against a backdrop of significant domestic policy change, and ongoing international discussions about the responsibilities of investors and about the stability and resilience of the global financial system. The policy measures that are being discussed and implemented cover issues such as fiduciary duty, disclosure and stewardship. Examples include, but are not limited to:

- The revised Fiduciary Rule, released by the US Department of Labor in April 2016 and due to come into effect later in 2016, which significantly extends the range of investment intermediaries whose advice is subject to a fiduciary standard.
- The decision by the US Department of Labor to rescind its 2008 Bulletin on Economically Targeted Investments. The Bulletin had been seen by investors as discouraging them from considering environmental and social factors in the companies and funds in which they invest.
- The release by the US Internal Revenue Service (IRS) of the Notice 2015-62: Investments Made for Charitable Purposes (September 2015) which explicitly enables foundations to consider their mission when undertaking investment.
- The introduction of Stewardship Codes or equivalent requirements in a number of countries including Japan (Principles for Responsible Institutional Investors, 2014), Malaysia (Malaysian Code for Institutional Investors, 2014), South Africa (Code for Responsible Investing in South Africa, 2011) and the UK (The Stewardship Code, 2010, revised 2012).
- The revisions of the European Union's Institutions for Occupational Retirement Provision (IORP) Directive.
- During its Presidency of COP 21, France's call in early 2016 for the OECD to examine how ESG factors are integrated into institutional investors' obligations and duties.
- The establishment of a Green Finance Study Group under China's presidency of the G20, which is examining the role of institutional investors, including questions relating to obligations and duties.
- The French Energy Transition for Green Growth Law, which came into effect on 1 January 2016, which strengthens the mandatory carbon disclosure requirements for listed and large unlisted companies, and the ESG disclosure requirements for institutional investors.
- Ontario's pension standards legislation (PPA909), effective in 2016, requires pension funds to state in their investment policies whether and how ESG factors are taken into account in their decision-making processes.

10. What do investors see as the primary obstacles to the adoption of investor obligations and duties such as those set out in the Statement?

Our research for the *Fiduciary Duty in the 21st Century* report found that the following are commonly cited barriers:

- The lack of regulatory clarity on investors' obligations and duties.
- The lack of explicit regulatory mechanisms for investors to take account of ESG issues in their investment processes, in their dialogue with companies, and in their engagement with policymakers.

- The lack of regulatory oversight and accountability, in particular in relation to ESG integration and engagement (or stewardship).
- Resource constraints, not least because of the growing complexity of the regulatory and other requirements faced by pension funds.
- Knowledge and understanding of ESG issues, both in terms of how these issues might effect investment performance and of how ESG integration and responsible investment might be implemented within the organisation.
- Personal values and perceptions, notably the common misperceptions that ESG issues are purely 'ethical' issues, that a focus on ESG issues involves compromising investment performance and that it is difficult to add investment value through a focus on ESG issues.
- Competing organisational priorities such as risk management and funding requirements which may lead to an excessive focus on short-term performance and a consequent lack of attention on long-term investment value drivers.
- The lack of consensus on good or best practice standards for responsible investment.

11. What are the next steps?

We will launch the Statement on 29 June 2016, and will be collecting signatories until December 2016.

12. Who can sign the Statement? How can my organisation sign up?

We encourage institutional investors – asset owners, asset managers, insurance companies, sovereign wealth funds, etc – to sign the Statement.

To become a signatory to the statement or for further information, please contact:
elodie.feller@unep.org and/or will.martindale@unpri.org.

We will report on the number of signatories and on the assets under management that they represent through www.fiduciaryduty21.org.

13. What are the expectations of signatories?

There is no cost associated with signing.

Signatories' names and logos will appear in PRI and UNEP FI communications about the statement, both in printed copies and on the web.

Signatory logos will only be used in the context of the Statement unless the PRI and UNEP FI have received explicit permission for other uses.

Signatories are not required to speak to the press, although they can choose to be spokespeople.

Being a signatory to the statement does not mean that signatories support any specific piece of legislation.

About the 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 issues and to support signatories in integrating these issues into investment and ownership decisions. The six Principles were developed by investors and are supported by the UN. They have more than 1,500 signatories from over 50 countries representing US$62 trillion of assets. They are voluntary and aspirational, offering a menu of possible actions for incorporating ESG issues into investment practices. In implementing the Principles, signatories contribute to developing a more sustainable global financial system. For more information, see www.unpri.org

About UNEP FI

The United Nations Environment Programme Finance Initiative (UNEP FI) is a unique global partnership between the United Nations Environment Programme (UNEP) and the global financial sector founded in 1992. UNEP FI works closely with over 200 financial institutions who have signed the UNEP FI Statements as well as a range of partner organizations 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 realize the adoption of best environmental and sustainability practice at all levels of financial institution operations. For more information, see www.unepfi.org

About The Generation Foundation

The Generation Foundation ('The Foundation') is the advocacy initiative of Generation Investment Management ('Generation'), a boutique investment manager founded in 2004. The Foundation was established alongside Generation in order to strengthen the case for Sustainable Capitalism. Its strategy in pursuit of this vision is to mobilise asset owners, asset managers, companies and other key participants in financial markets in support of the business case for Sustainable Capitalism, and to persuade them to allocate capital accordingly. For more information, see www.genfound.org

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