GLOBAL FORUM ON RESPONSIBLE BUSINESS CONDUCT

ALIGNING FIDUCIARY DUTY AND RESPONSIBLE BUSINESS CONDUCT IN INSTITUTIONAL INVESTMENT

Thursday 9 June 2016, 2:30pm-4:00pm, OECD Conference Centre, Auditorium, Paris

SESSION NOTE

Over the past decade, changes in investment practice and in public policy have created expectations for investors to integrate environmental, social and governance (ESG) issues into decision making where they are financially material.

A recent report by the UNEP and UNPRI[1] argues that failing to consider all long-term investment value drivers, including ESG issues, is a failure of fiduciary duty and concludes that ''integrating ESG issues into investment research and processes will enable investors to make better investment decisions and improve investment performance consistent with their fiduciary duties."

Policymakers in major economies have clarified and made explicit that investors may take ESG factors into account in certain circumstances. In the US, guidance from the Department of Labor clarified that for plans under the Employee Retirement Income Security Act (ERISA), where ESG issues are material to the economic value of an investment, those issues may form part of the fiduciary's analysis. In Ontario, Canada, legislation was recently introduced requiring pension funds to disclose information about whether and how their investment policies and procedures take into account ESG factors, spurring conversations amongst Canadian asset managers on understandings of fiduciary duty. South Africa has made consideration of ESG issues in the context of certain investment decisions mandatory. The South African Pension Act provides that "[the fund and its board must] consider any factor which may materially affect the sustainable long-term performance of the asset including, but not limited to, those of an environmental, social and governance character."

Indeed, investors are giving increasing attention to the impact of ESG factors in the context of their investments. This includes the recognition of long-term financial implications of environmental and social issues, and the development of stewardship codes and initiatives to encourage investors to monitor and engage with companies they hold investments in.

Longer-term thinking in markets should bring us closer to alignment between financial materiality and saliency of environmental and social risks, but that at present this is often not achieved. Some actors continue to perceive a misalignment between the expectation of institutional investors to prevent and mitigate ESG risks and the duty to generate a return on clients' assets. For example, in a recent survey by the CFA Institute, 73% of respondents stated that they took ESG issues into account in their investment analysis and of these, 63% said that they did so primarily to help manage investment risks.[2] However, at the same

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1 (Un Global Compact, UNEP, UNPRI, 2015) Fiduciary Duty in the 21st Century , 2015 available at http://unepinquiry.org/wp-content/uploads/2015/09/Fiduciary-duty-21st-century.pdf

2 . CFA (2015), Environmental, Social and Governance (ESG) Survey, June 2015, available at www.cfainstitute.org.

time, a survey of more than 100 institutional investors by Hermes Investment Management found that nearly half of respondents believed that pension funds should focus exclusively on maximising financial benefits to beneficiaries while just over a third believed that there should be more emphasis on quality of life factors.[3]

Fiduciary duty continues to be an evolving concept and a lack of concreteness with regard to how fiduciaries can best respond to expectations of their beneficiaries creates uncertainty amongst investors about when and to what extent ESG issues can be considered in their investment decisions. In the context of pension funds who manage assets on behalf of clients with interests in both short term and long term gains this is especially challenging. In addition to uncertainties regarding the boundaries of fiduciary duty, information deficiencies are another principle challenge to integration of ESG criteria within investment decisions. The lack of available, quantifiable, and comparable information regarding ESG risks represents a practical difficulty for asset managers which to a large extent rely on quantifiable metrics in making investment decisions.

This session aims to recognize evolving expectations of fiduciary duty and explore how institutional investors can respond to the interests and expectations of their beneficiaries while also considering ESG issues. It will seek to address questions such as:

- What is driving increasingly expansive interpretations of fiduciary duty within regulatory frameworks for investment?
- What accounts for the ongoing perception amongst some actors that a misalignment exists between the expectation of institutional investors to prevent and mitigate ESG risks and the duty to generate a return on clients' assets?
- How can we encourage broader interpretations of fiduciary duty and address challenges to stronger integration of ESG issues in the context of investment decisions?

II. Panellists

Moderator

- **Rob Lake**, Responsible Investment Consultant – *@roblake1959*

Panellists

- **Phyllis Borzi,** Assistant Secretary for Employee Benefits Security of the United States Department of Labor
- **Emmy Labovitch**, Principal Administrator, Financial Affairs Division, OECD
- **Stephanie Maier**, Head, Responsible Investment Strategy and Research, Aviva Investors – *@StephanieCMaier*
- **Heather Slavkin Corzo**, Director, Office of Investment, American Federation of Labor and Congress of Industrial Organizations (AFL-CIO)
- **Rachel Haworth**, Policy Officer, ShareAction – *@ShareActionUK*

3. Hermes (2015), "Responsible Capitalism and Our Society", *Hermes Investment Management,* October 2015, available at www.hermes-investment.com