Fiduciary Duty

Fact Sheet for Investors

Responsible Investment Association

The History

In many jurisdictions, fiduciary duty has been widely interpreted as the obligation of trustees and other fiduciaries to maximize investment returns. It arose from concerns that trustees would put their personal interests ahead of their beneficiaries. Legally, this interpretation was confirmed in 1985 in Cowan v Scargill, an English trusts law case, which established that trustees cannot ignore the financial interests of their beneficiaries.

For nearly two decades the outcome of that case was that pension fiduciaries around the world neglected environmental, social and governance (ESG) risks in the selection and management of investments. The result was that the focus was on short-term rather than long-term returns. This interpretation of fiduciary duty has been widely challenged in recent years.

ESG Considerations

A significant body of research has determined that ESG issues have a material impact on long-term investment returns. In 2005, the Freshfield's report concluded that "… integrating ESG considerations into an investment analysis so as to more reliably predict financial performance is clearly permissible and arguably required in all jurisdictions."

They went on to say that, "In our opinion, it may be a breach of fiduciary duties to fail to take account of ESG considerations that are relevant and to give them appropriate weight, bearing in mind that some important economic analysts and leading financial institutions are satisfied that a strong link between good ESG performance and good financial performance exists."

After the report was released, in 2006, the Principles for Responsible Investment (PRI) were launched by the UN and since then more than 2200 pension funds and other institutional investors representing more than $89.6 trillion have become signatories to the principles.

The Legal Question

A 2018 report by United Nations Environmental Programme Finance Initiative (UNEP FI) stated that the modern interpretation of fiduciary duty includes "the consideration of ESG issues in investing decision-making." One of the most important developments in the regulatory space is seen in Europe, where they are currently evolving their fiduciary duty to include ESG integration as a part of their regulatory requirements. As a result from the recommendations from the High-Level Expert Group on Sustainable Finance, the European Commission released a proposal to clarify investors' legal duty to consider sustainability factors in investment decisions.

In the words of United Nations Secretary-General Ban Ki-moon after the 2008 financial crisis:

"Some have argued that the ongoing financial crisis may not have been so deep or so protracted if institutional investors had been collectively willing to challenge the financial institutions that were at the heart of creating the systemic risks within the financial system. We also believe that one of the most important lessons from the crisis is that institutional investors' responsible ownership needs to be strengthened in order to be fit for purpose.

In conclusion, we believe that the global economy has now reached the point where ESG issues are a critical consideration for all institutional investors and their agents."

Evolving Requirements

While there are many different legislative regimes regarding fiduciary responsibility in Canada and around the world, integrating material ESG factors is fast becoming a mainstream function of good investment practice, resulting in better, more informed investment decisions.

The evolution of fiduciary responsibility as it pertains to ESG issues led the Ontario government to amend the pension fund investment regulations in 2016, requiring pension funds to include in their statements of investment policies and procedures (SIPPs), information about whether, and if so, how ESG factors will be incorporated into their decision-making process.

This requirement helps validate legal arguments that ESG factors can and should be taken in to account.

Sustainable Development Goals (SDGs)

In 2015, the United Nations General Assembly developed a collection of 17 global goals as part of Resolution 70/1 “Transforming our World: the 2030 Agenda for Sustainable Development”. The SDGs are a universal set of goals, targets and indicators that UN member states are expected to use to frame their agendas and political policies over a 15 year period starting in 2015. These goals aim to transform the world by 2030. Each of the 17 goals has its own list of targets to achieve, for a total of 169 targets. The goals include topics such as: poverty, gender quality, water, energy, environment. There has been a worldwide implementation at different retail and institutional levels.

The 2017 paper by the PRI “The SDG Investment case” says that the SDGs are likely to become the common framework with which to shape future investment decisions and against which to judge the utility of finance. Furthermore, the paper expands to say that institutional investors should be in the business of investing for the long term well-being of their beneficiaries and the SDGs provide the best guide as to how to build the world we all want.

Resources

https://www.unpri.org/sdgs/the-sdgs-are-a-critical-part-of-investors-fiduciary-duty/305.article
UN PRI, The SDG Investment Case

http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf
UNEP FI, Freshfield’s report

https://www.unpri.org/fiduciary-duty/fiduciary-duty-in-the-21st-century/244.article
UN PRI, Fiduciary Duty in the 21st Century

Challenges Ahead

The 2015 "Fiduciary Duty in the 21st Century” was published by the Principle of Responsible Investing (PRI) and it argues that failure to consider long-term ESG issues in investment practice is a failure of fiduciary duty. It reports that the importance of sustainability to business and investing is intensifying as financial markets are increasingly forced to address challenges.

Some of these challenges include outdated perceptions about fiduciary duty and responsible investment, lack of clarity, lack of transparency, inconsistencies in corporate reporting, and weaknesses in implementation, oversight and enforcement of legislation.

The progress will depend on effective collaboration between investors, policymakers, and other stakeholders. Active ownership also places an important role in our duty to act as stewards of assets.

The 2015 PRI report recommends that fiduciary duty is taken seriously by investors, that implementation of legislation and codes are strengthened, and the harmonization of legislation and policy instruments.

Responsible Investment Association

About the RIA

The Responsible Investment Association (RIA) is Canada’s industry association for responsible investment. RIA members include fund companies, financial institutions, asset management firms, asset owners, advisors, research firms, consultants and others who practice and support the incorporation of environmental, social and governance (ESG) factors into investment decisions.

Learn more at www.riacanada.ca