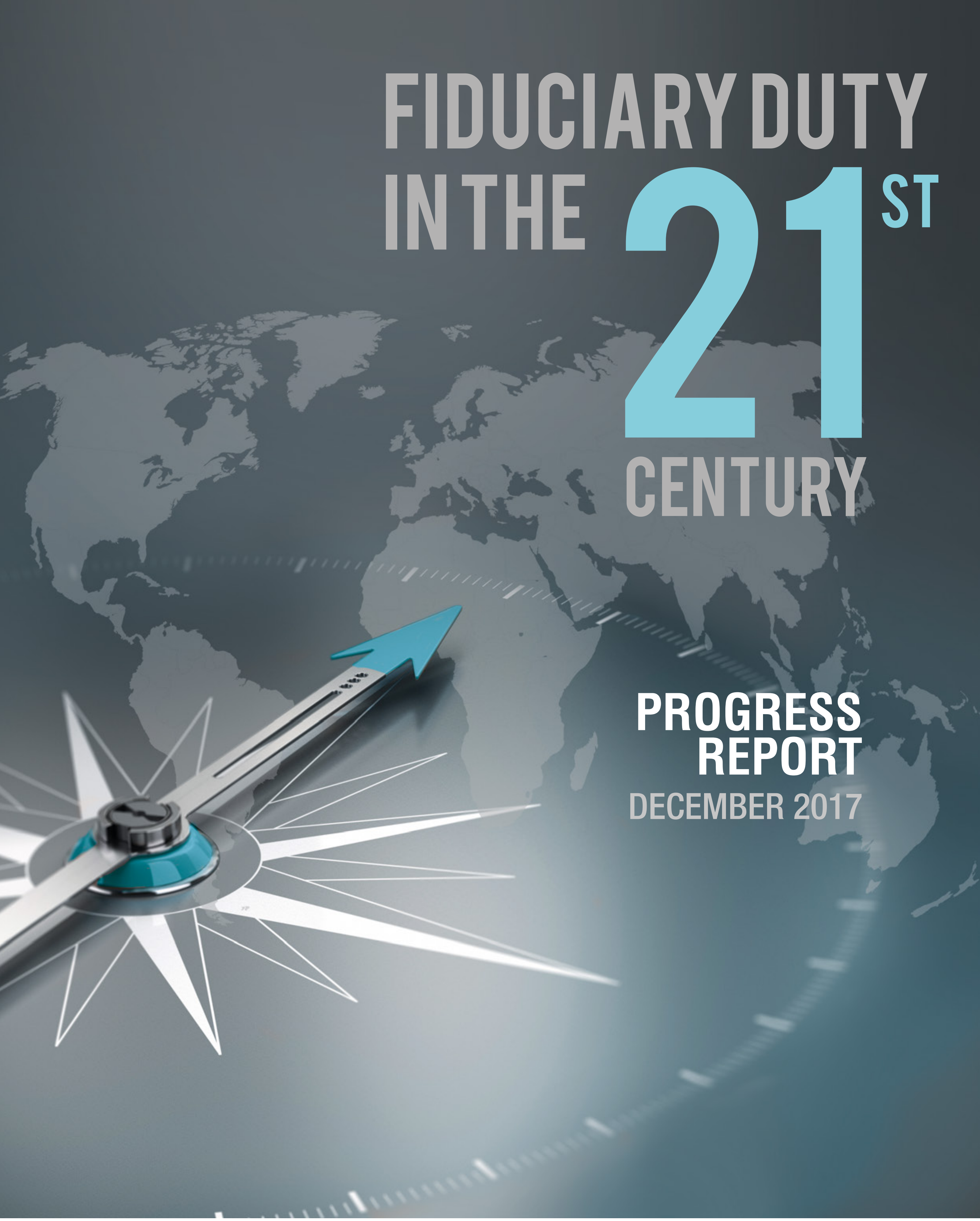
FIDUCIARY DUTY IN THE 21ST CENTURY



PROGRESS REPORT

DECEMBER 2017

UNEP FINANCE INITIATIVE

PRI Principles for Responsible Investment

generation foundation

THE FIDUCIARY DUTY IN THE 21ST CENTURY PROJECT

In this report, we reflect on the changing landscape of fiduciary duty and the progress that has been made to date. We also include details of the project's priorities for 2018 and 2019.

In January 2016, the Principles for Responsible Investment (PRI), UN Environment Finance Initiative (UNEP FI) and The Generation Foundation launched a three-year project—Fiduciary Duty in the 21st Century—that aims to clarify investors' fiduciary duties at national and international levels to include environmental, social and governance (ESG) issues.

Since its launch, the project has:

- Engaged with over 400 policymakers and investors to raise awareness of the importance of ESG issues to the fiduciary duties of investors.
- Published the Global Statement on Investor Obligations and Duties, which has now been signed by 123 signatories from 22 countries.
- Published and started to implement roadmaps on the policy changes required to achieve full incorporation of ESG issues into investment processes and practices across eight countries (Australia, Brazil, Canada, Germany, Japan, South Africa, UK and US).
- Extended the research into fiduciary duties—and, more broadly, investor duties—to six Asian markets: China, Hong Kong, India, Korea, Malaysia and Singapore.
- Hosted over 20 workshops and conferences with investors and regulators in 14 countries to discuss regulatory clarification and investor practice on ESG integration as part of the fiduciary duties of investors.
- Engaged with the European Commission High Level Expert Group (HLEG) on Sustainable Finance to help formulate recommendations on EU-wide clarification of investor duties in the European Union.

"Many of us have long heard the argument that a fiduciary's responsibility is to maximise short-term shareholder value without regard for external factors. We know it's not true. Common sense tells us it's not true. And the work of the *Fiduciary Duty in the 21st Century* project proves it to be untrue.

The *Fiduciary Duty in the 21st Century* project seeks to update perceptions of fiduciary duty and in doing so create the conditions for a more sustainable global economy. Two years after the publishing of the initial report, we are encouraged by the progress that has been made across the globe, but there is still a long way to go.

The final and most important phase of this work is now about to begin. Outdated conceptions of fiduciary duty cannot be allowed to stand in the way of progress towards a better economic system – at stake is a low carbon, prosperous, equitable and healthy planet in which human civilisation can flourish.

In fact, there is now voluminous academic research showing that in today's markets, the failure to take ESG factors into account may well be a violation of fiduciary duty."

AL GORE

Former US Vice President
Chairman of Generation Investment Management

Click to watch Al Gore introduce the Fiduciary Duty in the 21st Century project

THE CHANGING LANDSCAPE OF FIDUCIARY DUTY

CLARIFY INVESTMENT REGULATIONS ESG REQUIREMENTS IN THE UK

In their 2014 report, the UK Law Commission – the independent body tasked with promoting reform of the law – found that pension funds should do everything they can to promote the success of the fund, including considering financially material ESG issues.

The Law Commission's guidance, based on an extensive review of case law, also made clear that trustees must not "fetter their judgement" – they must "genuinely consider how to achieve a pension for their members and must not simply apply a pre-existing moral or political judgment".

On the back of this guidance, The Pensions Regulator has updated its guidance for defined benefit pension funds, and taken an increasingly strong stance on ESG risks.

However, the Investment Regulations, which govern how trust-based pension schemes operate, unhelpfully conflate social, environmental and ethical concerns, and suggest incorporation of ESG issues is optional – meaning that many trustees, and advisers, continue to misunderstand their fiduciary duties.

The EU IORP ii Directive requires occupational pension funds to disclose whether and how the materiality of environmental, social and governance factors are relevant to a scheme's investments. Transposition of the Directive gives the UK's Department for Work and Pensions (DWP) an opportunity to review and update the Investment Regulations to reflect the modern interpretation of fiduciary duty.

CLARIFY PENSION REGULATIONS ESG REQUIREMENTS IN BRAZIL

Since the launch of the Brazil Roadmap in February 2017, the PRI and UNEP FI have convened the country's regulators to discuss incorporating ESG issues in prudential regulation, stewardship codes and financial education initiatives.

PREVIC, the closed pension funds regulator, has approved the revision of Resolution CMN 3.792 that governs the industry's investment practices. The revision will clarify requirements for investors to integrate ESG issues into their investment practices and processes. In addition, the regulator plans to incorporate guidance on ESG integration in its Best Practice Guides by Q3 of 2018. SUSEP, the regulator for insurance and open pension schemes markets, plans to mirror PREVIC's ESG requirements in its regulatory framework in 2018.

In the regulated securities market, CVM has adopted the Brazilian Code of Corporate Governance, which requires companies to report on ESG issues.

EXTEND ESG DISCLOSURE REQUIREMENTS TO PENSION FUNDS IN ALBERTA

Canadian public pension plans were early adopters of ESG integration.

In 2014, the Government of Ontario updated its Pension Benefits Act to require Ontario-registered pension funds to disclose, in their Statements of Investment Policies and Practice (SIPPs), "information about whether environmental, social and governance factors are incorporated into the plan's investment policies and procedures and, if so, how those factors are incorporated".

The Financial Services Commission of Ontario (FSCO) subsequently published guidance (Investment Guidance Notes: IGN-004: Environmental Social and Governance (ESG) Factors) to help pension plan administrators meet the new requirement.

The PRI, UNEP FI and The Generation Foundation have prepared guidance for the Alberta government on how it might adopt and effectively implement similar requirements.

REVIEW PUBLIC PENSION FUND PRACTICES IN KOREA

The National Pension Service Act of Korea was amended in 2014 to require the government pension fund to consider ESG issues.

The Korean Stewardship Code was published in December 2016, which includes commitments to responsible investment. The FSC (Financial Services Commission) has encouraged investors to adopt the Code. KIC (Korean Investment Corp., the sovereign fund) and NPS (the National Pension Service) have not yet signed the Code, but have published commitments to do so. KIC has also publicly committed to invest $300 million in a dedicated ESG fund.

In 2017, the National Assembly Budget Office (NABO) launched a project with UNEP FI to review global public pension fund practices on ESG integration. As part of this review process, NABO is also examining questions of capacity and market expertise, and the other issues that would need to be addressed to be able to recommend the integration of ESG issues into investors' fiduciary duties.

PROTECT SHAREHOLDER RIGHTS IN THE US

The US Financial CHOICE Act includes a provision that would modify the Securities and Exchange Commission's shareholder proposal rule, SEC Rule 14a-8. The bill would alter the threshold for filing proposals to 1% of shares over a three-year period as well as alter the resubmission threshold for proposals.

Shareholders play a critical role in the corporate governance of US companies. Shareholder engagement has led to many substantial and important changes in board election practices, executive compensation and, in some instances, corporate strategy. The effectiveness of this engagement has required the ability to file resolutions and to exercise voting rights.

Drawing on the US fiduciary duty roadmap, the PRI has written to the House Committee on Financial Services in opposition to the Act.

CLARIFY INVESTOR DUTIES IN THE EU

EU Directives have begun to recognise the importance of ESG issues to investment decision-making. The 2014 Non-Financial Reporting Directive set in place minimum disclosure standards on ESG criteria for over 6,000 European companies, and ESG clauses were inserted into the revised IORP Directive, the Shareholder Rights Directive, the Securitisation Directive and the PRIIPS regulations.

Since the establishment of the EU High Level Expert Group (HLEG) on Sustainable Finance in late 2016 (to which the PRI is an international observer), the pace has accelerated. In 2017, the mid-term review of the capital markets union action plan recognised the importance of embedding sustainability into the EU financial system, including clarifying the relationship between investor duties and ESG issues and integrating ESG risks into the mandate of supervisory authorities.

The HLEG itself recommended the EU provide formal clarification, and in late 2017, the Commission launched an evidence gathering exercise on whether, and how, such a clarification could be provided. The Commission has committed to launch a comprehensive action plan in response to the HLEG's recommendations.

OVER 100 INVESTORS SIGN GLOBAL STATEMENT

The statement reads as follows:

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.

Signatories to the statement can be found online.

TIMELINE OF ACTION

2005		UNEP Finance Initiative publishes *A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment* (the Freshfields report). The report concludes that ESG integration is clearly permissible and arguably required.
2006		Launch of the Principles for Responsible Investment.
2009		UNEP Finance Initiative publishes *Fiduciary Responsibility: Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment.*
2014		
	Jul	The UK Law Commission publishes *Fiduciary Duties of Investment Intermediaries*. The report concludes that: "There is no impediment to trustees taking account of ESG issues where they are, or may be, financially material".
	Sep	PRI reaches 1500 signatories. At the PRI's annual conference, signatories identify "misperceptions of fiduciary duty" as the biggest barrier to responsible investment.
2015		
	Sep	PRI, UNEP Finance Initiative, UN Global Compact and UNEP Inquiry into the Design of a Sustainable Financial System publish *Fiduciary Duty in the 21st Century*. The report concludes that: "Failing to integrate ESG factors is a failure of fiduciary duty". It makes recommendations to international and national policy makers, investors and service providers.
	Oct	The US Department of Labor releases Interpretive Bulletin (IB 2015-01), which states "ESG factors may have a direct relationship to the economic and financial value of an investment, and when they do these factors are proper components of the fiduciary's analysis".
2016		
	Jan	PRI, UNEP Finance Initiative and The Generation Foundation launch a three-year project to clarify investors' duties and obligations on ESG integration in legislation and policy.
	Jun	The Global Statement on Investor Obligations and Duties launched to clarify that investor obligations and duties require consideration of ESG issues in investment decisions and processes. The Statement is supported by the French government and by 123 investors from 22 countries.
	Sep	*Investor Duties and Obligations in 6 Asian Markets* report launched.
	Oct	UK roadmap launched. In July 2017, FCA publishes its asset management market study recommending that asset consultants come under the FCA's regulatory perimeter. Also in July 2017, the Law Commission publishes its study on pension funds and social investment.

Oct	US roadmap launched. In December 2016, DoL publishes Interpretive Bulletin relating to the exercise of shareholder rights, saying there are "financial benefits" to engaging companies on ESG issues. In February 2017, the Investor Stewardship Group (ISG) publishes stewardship and corporate governance codes.
Dec	Australia roadmap launched. In July 2017, Financial Services Council (FSC) launches compulsory stewardship code for asset manager members.
2017	
Jan	Canada roadmap launched. In July 2017, the Canadian Securities Administrators launches a consultation on climate disclosures. The PRI, SHARE, CCGG and many Canadian investors write to the Alberta government on minimum shareholder filing requirements.
Feb	Brazil roadmap launched. PREVIC, the closed pension funds regulator, approves the revision of Resolution CMN 3.792, to clarify requirements to integrate ESG issues.
Apr	South Africa roadmap launched. In December 2017, the PRI, UNEP FI and The Generation Foundation provide access to the PRI online academy to train South African pension fund trustees on ESG issues and fiduciary duties.
May	Japan roadmap launched. In May 2017, the FSA consults with investors on its Stewardship Code. In October 2017, GPIF revises its investment principles to incorporate ESG.
Jul	German roadmap launched. In September 2017, the PRI and German investors launch the “Hub for Sustainable Finance” (H4SF), which has adopted the German roadmap.
Jul	The European Commission’s High Level Expert Group (HLEG) on Sustainable Finance publishes interim report recommending EU-wide clarification of fiduciary duties, building on The Global Statement on Investor Obligations and Duties. The OECD’s report Investment Governance and the Integration of Environmental, Social and Governance Factors makes similar recommendations.
Sep	Following the revision of the 2015 amendment to the National Pension Service Act the South Korean National Assembly Budget Office (NABO) launches a pilot project to review public pension funds’ practices on ESG integration.
Sep	UK Department for Business, Energy and Industrial Strategy (BEIS) and HM Treasury launch a Green Finance Taskforce to bring together senior leaders from the financial sector, including PRI managing director, Fiona Reynolds. The Taskforce is expected to make recommendations on clarifications of fiduciary duty.
Nov	The European Commission launches a public consultation on institutional investors and asset managers' duties regarding sustainability.
Nov	PRI and UNEP FI win IPE's award for outstanding contribution to the pensions industry of Europe for the *Fiduciary Duty in the 21st Century* programme.

FIDUCIARY DUTY IN THE 21ST CENTURY PRIORITIES FOR 2018 AND 2019

The project has moved from a process of dialogue to investor and policy engagement. The project team is engaging investors and policymakers in each jurisdiction to adopt policy measures that clarify and formalise fiduciary duties to incorporate ESG issues.

AUSTRALIA	• APRA should update paragraphs 34 and 36 of Prudential Practice Guide SPG 530 to clarify to superannuation funds that ESG issues are material to risk and return analysis.
BRAZIL	• The Superintendence of Private Pension Funds (PREVIC) should ensure maximum support and uptake of its new Resolution and Instruction on Closed Pension Fund Investments by market participants. • CVM should support market uptake of the Brazilian Association of Capital Market Investors' (AMEC) stewardship code.
CANADA	• Pensions regulators should extend the ESG requirements of the Ontario Pension Benefits Act to other provinces. • The Canadian Securities Administrators (CSA) should conduct a comprehensive review of the disclosure of material ESG factors, aligning disclosure requirements with the FSB Taskforce on Climate-related Financial Disclosures (TCFD) recommendations.
CHINA	• The report Investor Obligations and Duties and ESG integration in China will be published in early 2018 in partnership with the International Institute of Green Finance of the Central University of Finance and Economics in China.
EU	• The EU should clarify fiduciary duty requirements and ESG integration.
GERMANY	• The Ministry of Finance should amend the Pension Insurance Act (following the implementation of the EU-wide IORP II directive) to clarify that all institutional investors should consider financially material ESG issues.
JAPAN	• The Ministry of Health, Labour and Welfare (MHLW) should require pension schemes to disclose how they consider ESG issues in their investment processes. • Corporate plans should be encouraged to sign the Stewardship Code.
SOUTH AFRICA	• The South African Financial Services Board (FSB) should provide practical guidance to enhance the impact of Regulation 28 on the investment practice of South African pension schemes and actively monitor progress in scheme practice.
UK	• The DWP should clarify the Investment Regulations (following the implementation of the EU-wide IORP II directive) to clarify that pension funds should consider financially material ESG issues. The DWP should also introduce a stewardship duty for pension funds to deploy their rights as shareholders. • The DWP should consider ESG issues as a component of pension fund consolidation. • The FCA should strengthen the ESG requirements of Independent Governance Committees (IGCs).
US	• The House and Senate should not pass the Financial CHOICE Act. • The Department of Labor (DOL) should publish analysis of ERISA-governed plans' governance structures on ESG issues in comparison to international and public US peers.

CREDITS

This report has been prepared by Will Martindale, Elodie Feller and Rory Sullivan, with thanks to the fiduciary duty project team: Grace Eddy, Rebecca Elliott, Alyssa Heath, Melanie Paty, Margarita Pirovska, Marcelo Seraphim and Jenny Waits.

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