



MyFiduciary

SRI and Fiduciary Duty

APAFS Webinar

10 March 2021

Investment Fiduciary



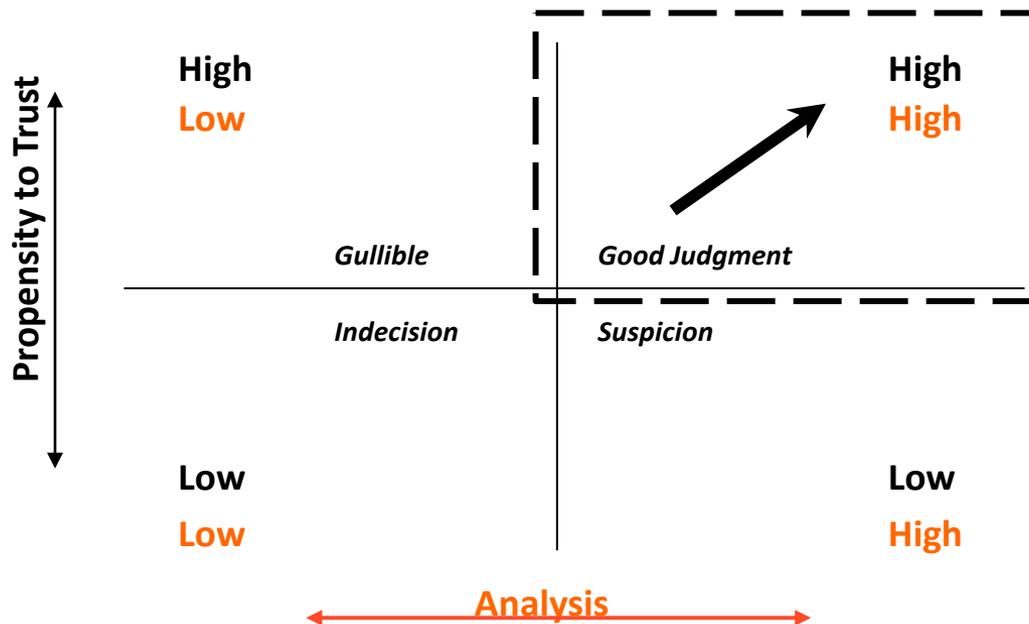
Investment Fiduciary

Someone who is managing the assets of another person and stands in a special relationship of trust, confidence, and/or legal responsibility.

Fiduciary duty is all about **justified** trust

Key universal fiduciary duties are:

1. Prudence – act with care, skill, diligence and knowledge of a “prudent expert”.
2. Loyalty – act in the best interest of the client or beneficiary.



Source: Stephen (M R) Covey
"The Speed of Trust"

TRUST = INTEGRITY + COMPETENCY + DOING THE RIGHT THING

Fiduciary Roles



Stewards

Manage the investment decision making process; e.g. Trustees.



Advisors

Provide comprehensive and continuous investment advice to Stewards.



Managers

Make investment decisions and selects investments to implement a specific investment mandate.

SRI needs to be considered and consistently applied by Stewards, Trustees and Managers.

Any gap in chain is a potential *fiduciary breach*, or at least a *best practice shortfall*.

SRI and Fiduciary Obligations

- Historic legal opinion was *unless required* by enabling legislation or a Deed, SRI should not be considered because it entails a potential breach of fiduciary duty.
- The pendulum has shifted as evidence has shown factoring ESG into an investment processes can reduce risk and at least do no harm to returns:
 1. Reflected in global prudent practice standards such as Fi360's Prudent Practices.
 2. Clearly seen as part of best practice by "pinnacle" fiduciaries such as Sovereign Wealth Funds and large pension Funds in Europe and parts of the US.
 3. Legal opinions globally mounting that **failure to consider SRI or related risks like Climate Change** is a **potential fiduciary breach**.

SRI and Fiduciary Obligations

In response, regulators and agencies increasingly provide guidance and/or prescriptive regulations around how providers must factor in SRI:

- UN's Fiduciary Duties in the 21st Century conclude there is a **positive duty to incorporate ESG into a fiduciary's investment governance. Failing to integrate ESG issues in investment decision-making is a failure of fiduciary duty.**
- In the UK, the Pensions Regulator published a new Defined Contribution Code and trustee guide in July 2016 – **no legal obstacle to integrating ESG, encourages trustees to consider long-term sustainability of investments.**
- In South Africa, the 2011 Amendment to the Pension Funds Act states that **"Prudent investing should give appropriate consideration to any factor which may materially affect the sustainable long-term performance of a fund's assets, including factors of an environmental, social and governance character."**
- In the EU, 2019 pension fund governance and investment regulation (IORP II) explicitly sets out that **the "prudent person" should consider ESG factors, in terms of both the potential impact on portfolio risks and returns and the institutional investor role as long-term investors.**
- In New Zealand, default private sector pension providers (KiwiSaver) **must have an SRI policy and incorporate ESG into their investment decision-making** as part of meeting criteria to be appointed a provider. Legal opinion is that failure to consider SRI and climate change constitutes a fiduciary breach.

In the Pacific things are lagging despite the Climate Change risks....

What does SRI and Fiduciary Duties mean in practice?

Treat it as an **integral part of the Organise, Formalise, Implement and Monitor** steps of good investment governance.

Organise

- All Trust Deeds and enabling legislation must be scrutinised for what their explicit or implicit SRI obligations entail. Trustees and Advisers serving Trusts must take this into account.
- Fiduciaries (or certainly Advisers and Asset Consultants they engage) must keep abreast of the empirical evidence on how ESG factors impact risk and returns and evolving regulatory obligations and legal opinion.
- Need to distil this into a clear **belief** around ESG and what it means for your investment organisation, e.g. MyFiduciary SRI belief:

| Belief | Implication for what we do |
|--|--|
| Responsible investors who manage environmental, social, governance and cultural (ESGC) factors do better over the long term. | We will design and offer our clients model portfolios with superior ESG characteristics. We will consider ESG as part of the Manager and investment due diligence and monitoring processes. |

What does SRI and Fiduciary Duties mean in practice?

Formalise

- **Investment Policy Statements document the approach taken to SRI**, or if elected not to pursue, clearly document why not. Omission implies that a beneficiary/client could challenge it not being considered at a future date.
- In the Policy need to clearly distinguish between **financially based SRI vs ethically based exclusions and/or impact investments**.

Investing in the latter may be a fiduciary breach unless its clearly understood and approved by beneficiaries or clients and/or is part of Trust deeds (governing documents) or enabling legislation.

What does SRI and Fiduciary Duties mean in practice?

Implement

- Due diligence of **fund managers** should include the managers approach to ESG *even if* an organization elects not to pursue SRI funds. This is because evidence overwhelmingly suggests consideration (esp. G) matters.
- Look for managers that go the extra mile. See our presentation “SRI and fund manager due diligence - Making sure your manager walks the talk” <https://www.myfiduciary.com/fiduciary-perspectives.html>

SRI 1.0

Become a signatory to the UNPRI

Exclude the standard sectors – tobacco, controversial weapons, etc

SRI 2.0

Full integration into the investment process

Active ownership – voting, engagement with companies

Seeking out positive opportunities

Portfolio weights are affected by ESG views / scores

Across multiple asset classes, not just equities

ESG factors built into valuation models

SRI training. Part of company culture

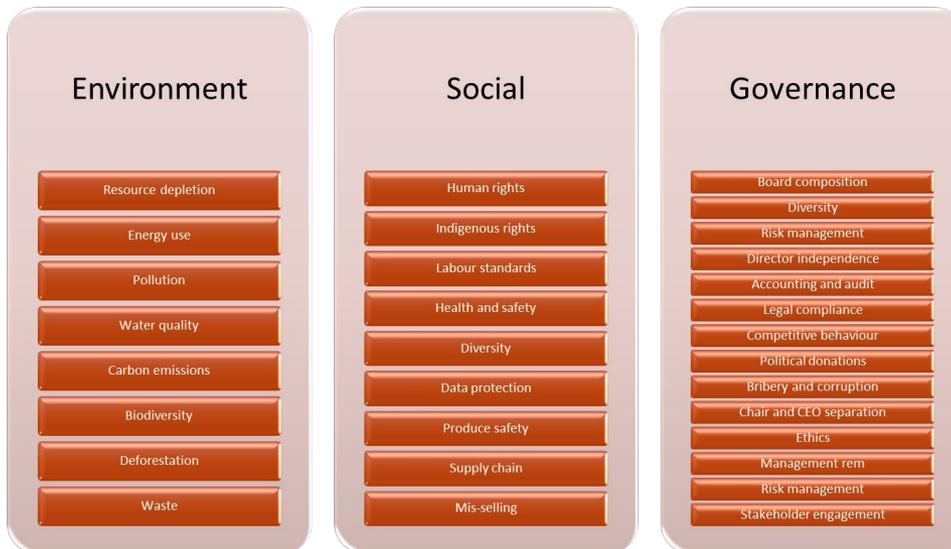
Data-based reporting on what the manager has done

Binary exclusions are a last resort

What does SRI and Fiduciary Duties mean in practice?

Implement

- SRI even more importantly for direct and private market investments because fiduciary and general Director duty obligations are much “closer” c/f engaging external funds:
 - You have greater control, and therefore greater responsibility
 - If you are involved in governance – and you should be – then you will have legal responsibilities and risks
 - You have greater reputational risk



See our presentations “SRI and Direct Investing” and “Impact Investing”

<https://www.myfiduciary.com/fiduciary-perspectives.html>

What does SRI and Fiduciary Duties mean in practice?

Monitor

- Regular (e.g. quarterly) portfolio, fund and investment monitoring needs to review whether SRI obligations are being met. Failure to do so may be breach
- You (or your Advisers) monitoring of externally managed funds should keep abreast of the market and whether it is offering superior options to your current investments.
- **In investee companies:** Adequate reporting on ESG to a Board level. For instance, an ESG dashboard, clear policies, annual deep-dive assessments, third-party reviews, enhanced engagement with shareholders and other key stakeholders.
- Build in regular (e.g. every 3 years) reviews of your approach to SRI and how ESG will be factored into investment due diligence and monitoring.
- Consider setting goals or targets such as measuring and reducing carbon footprints in the portfolio over time.

It's a journey - the fiduciary norm with regards SRI will evolve as evidence, taxonomies, data, accreditation, investable options and regulations change.