

# Presentation to RI New Zealand 2019 Conference

## SRI and Fiduciary Responsibilities

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**MyFiduciary**



# Investment Fiduciary



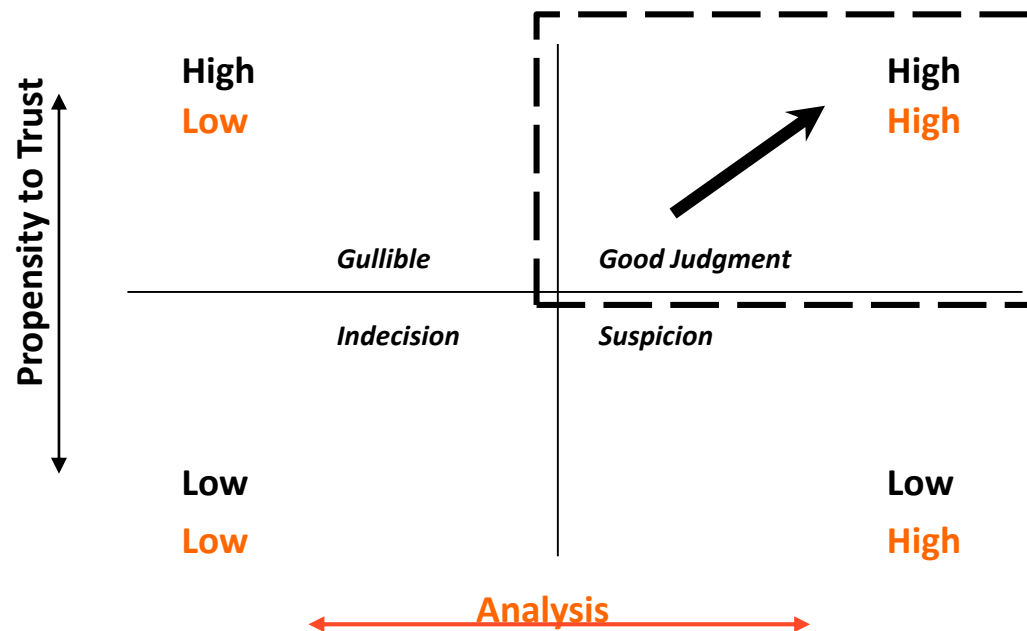
## **Investment Fiduciary**

**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

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## 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

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- 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 advice and investment processes can reduce risk and at least do no harm to returns:
  - Clearly seen as part of best practice by “pinnacle” fiduciaries such as NZ Super.
  - NZ Community Trust Sector increasingly allocating to “impact investing”, legal opinions sought do not preclude this. Iwi and Maori Trusts similarly leading development.
  - Reflected in global prudent practice standards such as Fi360’s Prudent Practices.
  - Legal opinions (offshore) mounting that **failure to consider SRI is a potential fiduciary breach.**

# SRI and Fiduciary Obligations

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- In response, offshore regulators and agencies increasingly provide guidance and/or prescriptive regulations around SRI:
  - UN's Fiduciary Duties in the 21<sup>st</sup> Century conclude there is a **positive duty to incorporate ESG into a fiduciary's investment governance**
  - 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.**

# SRI and Fiduciary Obligations

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- Currently NZ fiduciaries are not, in general, bound to consider SRI by legislative or regulatory means:
  - There is no explicit mention of SRI in the new Trust Act 2019 (Trustee duties) or FSLAA 2019 and the Code of Conduct (Adviser obligations and FAP licensing).
  - Little explicit guidance or requirement for KiwiSaver scheme providers under its Act.
  - SRI obligations are not specified in Act's governing CFIs like NZ Super.
- Regulators need to play catch up in NZ to offshore counter-parts and how our industry has been embracing SRI, but in the meantime....

**....fiduciary duty to include SRI can be motivated as a necessary part of duty of care (prudence) and loyalty (knowing your client or beneficiaries) obligations.**

# What does SRI and Fiduciary Duties mean in practice?

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- Fiduciaries (or 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, 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 selection and monitoring process.

**ESG may be correlated with superior performance but what is prudent?**

**We can't be precise, the how much and how best to integrate ESG remains a judgement.**



# What does SRI and Fiduciary Duties mean in practice?

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- 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.
- **Advisers need to take the lead** - actively inform Trustees of their SRI obligations as part of their co-fiduciary role. For retail clients all should be asked about their SRI preferences and educated on what the evidence suggests.
- **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?

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- Due diligence of fund managers needs to include the managers consideration of ESG *even if* a client elects not to pursue SRI funds. This is because evidence overwhelmingly suggests consideration of ESG (esp. G) matters.
- Similarly and even more importantly for direct and private market investments, despite much larger data and measurement challenges.
- Portfolio, fund and investment monitoring needs to review whether SRI obligations are being met, and/or whether the market is offering superior options.

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