European Investors' Autumn event
Brussels, 13 September 2018

Conference paper 'Fiduciary Duties for Investors'

THEME

European Investors promotes the interest of investors. This implies that we foster long-term sustainable growth, both for society and for the companies institutional investors are investing in. The theme of European Investors' Autumn event 2018 is *fiduciary duty of institutional investors*.

In the financial world, acceptance is mounting that a fiduciary relationship exists between those to whom power is entrusted to invest and the fund beneficiaries. Taking it from the 2018 ICGN Guidance, *Implications of Fiduciary Duty for Institutional Investors*, fiduciary duty also gets to safeguard the current and future interests of fund beneficiaries, both to enhance value and to protect them from potential misuse of their assets, owing to negligence, conflicts of interest (or agency issues) and/or incompetence in the performance of institutional investors' responsibilities.

At the EU level, fiduciary duty is partly codified in a number of directives, but even within the EU legislative instruments, standards differ greatly. Some offer possibilities for departures

from acting in the best interests of clients in a way that is inconsistent across jurisdictions. Even though existing investment regulations allow material ESG factors to be incorporated into decision-making, the degree to which such considerations are mandatory and how potential conflicts with other considerations are resolved are unclear. Naturally, 'other considerations' points to the duty to maximise the returns for the clients and beneficiaries.

A quote from the EU High-Level Expert Group on Sustainable Finance:

> *'there is a growing consensus that financial intermediaries, which manage money on behalf of others or give advice, have an obligation to include considerations of sustainability as part of their duty to their beneficiaries and clients.'*

Sustainable finance pits institutional investors against a challenge. Within the investment decision- making process institutional investors have to take due account of environmental and social considerations. Many support the view that sustainable finance boosts competitiveness. It does so by improving the efficiency of production processes and reducing the costs of assessing and managing resources. However, institutional investors also have to strive for a decent return on investment, both in the short run as over many years.

The EU High Level Expert Group on Sustainable Finance is perfectly aware that sustainable finance as an integral aspect of fiduciary duty poses great challenges:

> *'bringing this approach into the mainstream requires a number of important legal, conceptual and practical clarifications.'*

The *Principles for Responsible Investment* has a work programme that has developed a number of resources covering fiduciary duty and investor duties and responsibilities across a range of common and civil law jurisdictions, with a main focus on the link between ESG related factors and fiduciary duty.

Towards practical clarification, the 2018 ICGN Guidance put forward a lot of initiatives for institutional investors to modify their policies with the focus of fulfilling their investor fiduciary duties. Institutional investors are also increasingly reporting on their progress in meeting the *United Nations' Sustainable Development Goals*, a framework of 17 global goals which address societal risks such as gender equality, protection of fragile ecosystems, and encouraging sustainable infrastructure.

DILEMMAS

With the current legislative initiatives, the need for clarification on definitions, harmonisation and convergence of regulation, and a future-proof framework of duties and responsibilities of institutional investors, is becoming ever more important.

Arguably, institutional investors may be excused for their inability to see the wood for the trees. Many dilemmas and questions rise when debating fiduciary duties of investors. During the conference we focus on four dilemma's and related questions.

A: Fiduciary duty pits institutional investors and asset managers against a dilemma between their duty to maximise short term results and sustainability factors and risks.

1. How to define short and long term related to investment policies and strategies?
2. How to define (investment) risks related to sustainability factors?
3. How to strike a balance in investment policies between the short-term financial results and long-term sustainability factors?

B: There is consensus on the importance of sustainability for society. This forces us, for instance, to consider the global effects of climate change. Clearly, having investment policies reflecting fiduciary duty, impacts results. But this change of thought comes at a cost for institutional investors.

1. How severe are the restrictions for institutional investors because of the rising attention for sustainability and fiduciary duty?
2. When formulating investment policies anno 2018, are there any new considerations compared to three years ago?
3. Is it possible to measure the cost for institutional investors of disinvesting, excluding of inclusion policies and being compliant with several responsible investments codes?

C: Institutional investors should subordinate their clients' interests to the protection of the integrity of the financial system. The duty to protect fund beneficiaries from misuse of their assets, may cause an institutional investor to take legal action to seek compensation for investment losses.

1. What are key elements of the integrity of the financial system and which of these elements are manageable or influenceable by institutional investors?
2. What are measures to be taken by institutional investors to protect the fund beneficiaries?
3. What level of activism of institutional investors is needed duly to protect the fund beneficiaries and strive for recovery of losses?

D: The discussion on fiduciary duty is extended by defining sustainability and systemic risk as an integral component thereof for investors.

1. Is it far-fetched to hold institutional investors to account on the consequences of their actions on the environment, both in the near future as in longer term?
2. How should institutional investors oversee management of systemic risk?
3. Should institutional investors regularly inform their beneficiaries and other stakeholders on how they manage sustainability and systemic risk?