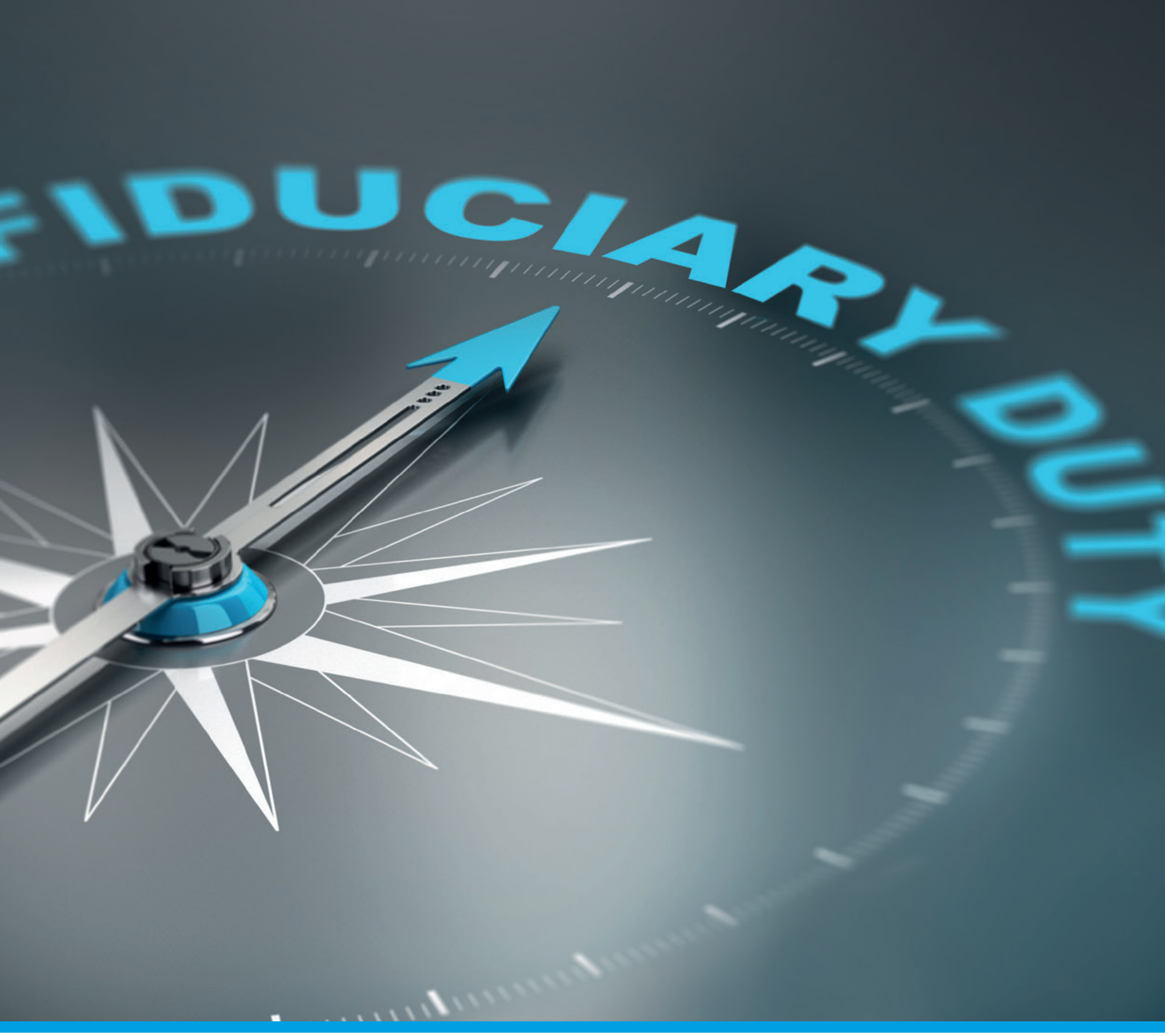
COMPLYING WITH YOUR FIDUCIARY DUTY:

A GLOBAL ROADMAP FOR ESG INTEGRATION

FRESHFIELDS: 10 YEARS ON



United Nations Global Compact

UNEP

Inquiry: Design of a Sustainable Financial System

PRI Principles for Responsible Investment

UNEP FINANCE INITIATIVE

FRESHFIELDS: 10 YEARS ON

In 2005, a group of UNEP FI asset managers together with legal firm Freshfields, published a ground-breaking report titled: *A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment.*

The report, widely referred to as the Freshfields report, argued that *"integrating ESG considerations into an investment analysis so as to more reliably predict financial performance is clearly permissible and is arguably required in all jurisdictions."*

In the months that followed, a group of investors, led by UN Secretary-General, Kofi Annan, developed and subsequently launched the Principles for Responsible Investment (PRI) at the New York Stock Exchange. The six principles commit signatories to integrate ESG issues into investment decision-making and ownership practices.

The 2005 Report

"Ten years after the original Freshfields report, many investors have made positive steps to incorporate sustainability risks such as climate change into the way their deliver their fiduciary duty. But too many assets are still managed with a 20th century mindset, exposing savers and beneficiaries to the threat of disruption and value destruction."

Nick Robins
Co-Director
UNEP Inquiry

THE PRI HAS NOW GROWN TO OVER 1300 SIGNATORIES REPRESENTING US$45 TRILLION - HALF THE INSTITUTIONAL INVESTOR MARKET

Many of the PRI signatories have established processes to research and analyse ESG issues and to take account of these in their investment processes, and there are now multiple examples of these issues materially affecting investment decisions.

DESPITE SIGNIFICANT PROGRESS, CHALLENGES REMAIN. MANY LARGE INVESTORS HAVE YET TO SIGN THE PRI OR MAKE EQUIVALENT COMMITMENTS TO RESPONSIBLE INVESTMENT. EVEN AMONG PRI SIGNATORIES, MOST INVESTORS HAVE YET TO FULLY INTEGRATE ESG ISSUES INTO THEIR INVESTMENT PROCESSES.

FIDUCIARY DUTY

WHAT IS FIDUCIARY DUTY?

Fiduciary duties exist to ensure that those who manage other people's money act in the interests of beneficiaries. Fiduciary duties are generally seen as requiring a higher standard of performance than those that are imposed in contracts. The most important fiduciary duties are:

- Loyalty: Fiduciaries should act in good faith in the interests of their beneficiaries and impartially balance the conflicting interests of different beneficiaries. They should avoid conflicts of interest and should not act for the benefit of themselves or a third party.
- Prudence: Fiduciaries should act with due care, skill and diligence, investing as an 'ordinary prudent person' would do.

Fiduciary duties may also determine whether long term factors should, or must be considered in the investment-decision making process. This project will provide a contemporary analysis of the finance industry's views on fiduciary duty. It will examine how recent legal developments and the growing understanding of the investment case for focusing on ESG issues have affected both investment practice and investor perceptions.

THE EVOLUTION OF FIDUCIARY DUTY AND ESG INTEGRATION

The 2014 PRI Report on Progress showed that 67% of asset owner signatories ask their investment managers to integrate ESG issues into their investment processes.

For listed equities, 83% of investment managers and 73% of asset owners reported that they integrated ESG issues into their investment portfolios, to at least some degree.

Policy and regulation has also evolved. Examples include the UK Law Commission's review of the fiduciary duties of investment intermediaries, the Japanese Stewardship Code, the Code for Responsible Investing in South Africa and the European Union's Non-financial Reporting and Shareholder Rights Directives.

Despite significant progress, too many investors are not yet considering ESG issues in their investment research and decision-making.

Furthermore, even with investors that do accept the argument that they should consider ESG issues in their investment processes, implementation remains variable.

The central objective of this project is to understand why investors are not systematically integrating ESG as part of their fiduciary duty.

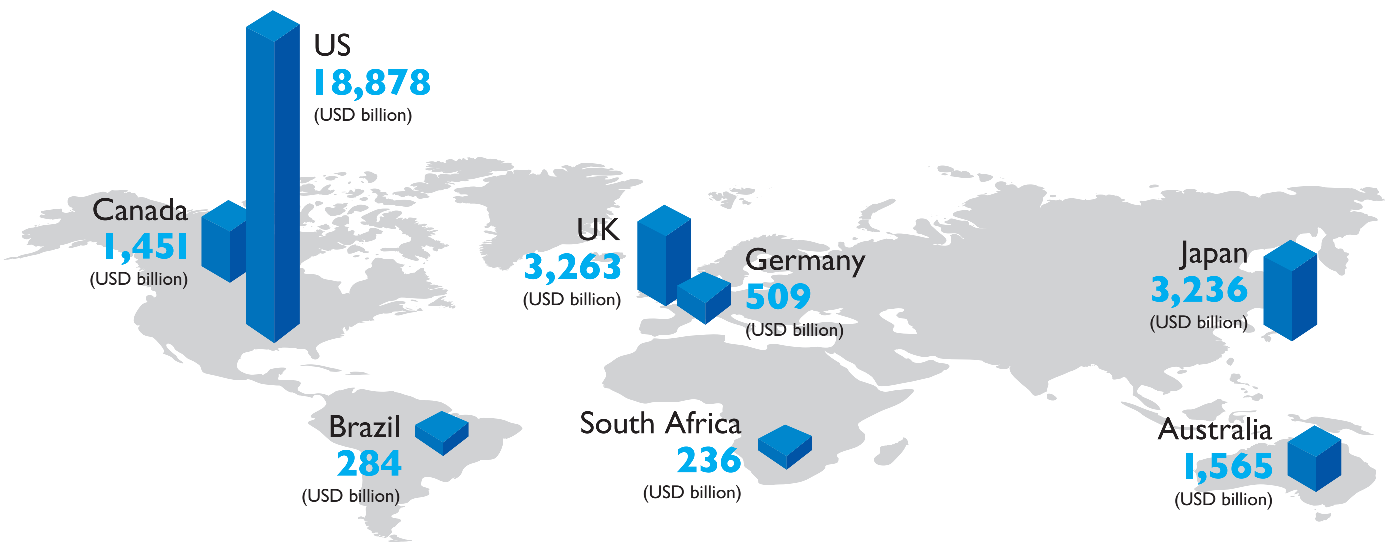
THE REPORT WILL PROPOSE PRACTICAL ACTIONS FOR INSTITUTIONAL INVESTORS AND POLICY-MAKERS TO ADDRESS THESE BARRIERS.

ABOUT THIS PROJECT

Senior investment professionals, lawyers, regulators and policy-makers will be interviewed across eight economies to identify steps to facilitate, scale up and strengthen the process of integrating ESG into fiduciary duties.

- Over 50 high level interviews across eight countries
- 4 stakeholder roundtables in Japan, US, UK and Australia
- 2 webinars
- Global launch

Figure 1: Targeted countries pension assets, 2013. Source: Tower Watson and secondary sources, 2014.



Preliminary findings from interviews and roundtables will be presented to investors in June 2015. The project team will consult with experts before publishing the report in September 2015.

While the central focus of this project is to understand the barriers to ESG integration, the report will also explore two wider themes.

- The first is the relationship between fiduciary duty and responsible investment, specifically whether fiduciary duty is solely or primarily about ESG integration or whether, and under what conditions, fiduciary duty imposes obligations on investment organisations to engage with the companies in which they are invested and to engage with public policy matters on ESG-related issues.
- The second relates to the framing of investment objectives, both in relation to investment timeframes (i.e. the implications of short investment timeframes for investment decision-making) and in relation to the question of whether investors' fiduciary duties require them – or could be adapted to require them – to consider the implications of their investment activities on wider society and on the environment.

TABLE OF CONTENTS

PROJECT STEERING COMMITTEE

- David Pitt-Watson, Co-Chair, UNEP FI
- Fiona Reynolds, Managing Director, PRI
- Nick Robins, Co-Director, UNEP Inquiry
- Gavin Power, Deputy Director, UN Global Compact

CORE PROJECT TEAM

- Elodie Feller, UNEP FI
- Will Martindale, PRI
- Jaime Garcia Alba, UN Global Compact
- Rory Sullivan, consultant

To learn more about the project, please contact:
Elodie Feller (elodie.feller@unep.org) or
Will Martindale (will.martindale@unpri.org) or visit the UNEP FI Website.

This project is being undertaken in collaboration with the European Commission, DG ENV is also conducting a parallel study focusing on resource efficiency and the fiduciary duties of investors, primarily on countries within the European Union.

JAN 2015	
FEB 2015	Multistakeholders roundtables and bilateral interviews
MAR 2015	
APR 2015	
MAY 2015	
JUN 2015	Preliminary Results Webinar
JUL 2015	Global Peers Review
AUG 2015	
SEP 2015	PRI in Person Launch
OCT 2015	UNEP FI Annual Meeting
NOV 2015	
DEC 2015	Conference of the Parties 21