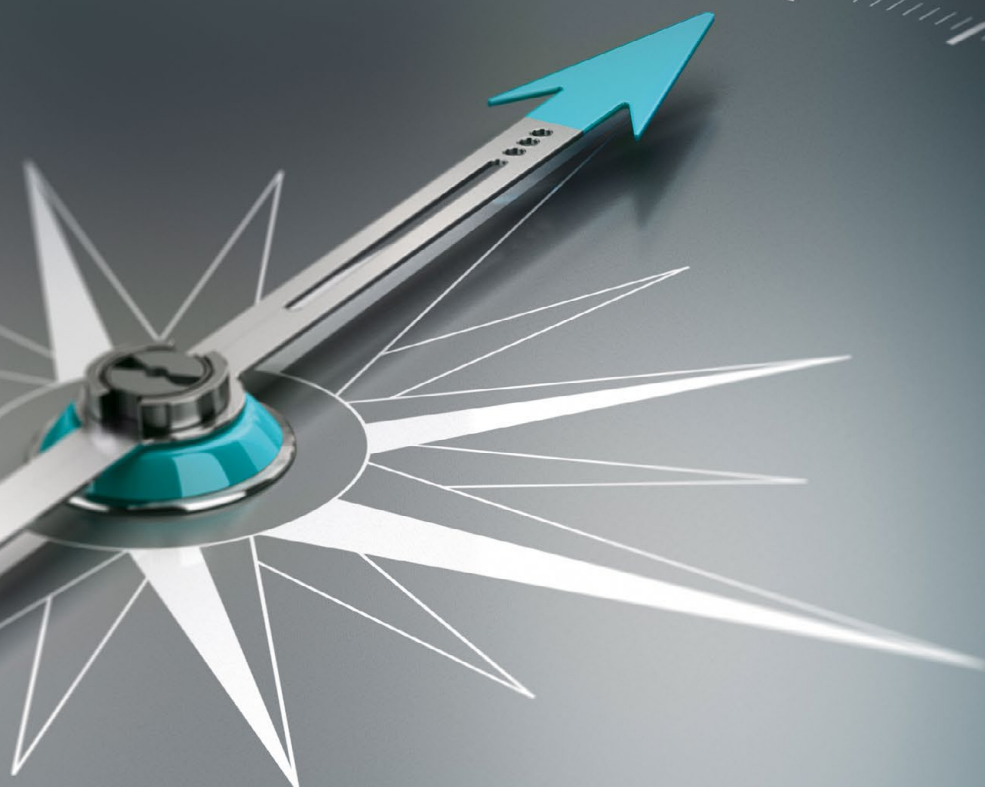


# FIDUCIARY DUTY IN THE 21<sup>ST</sup> CENTURY

**FINAL REPORT**



# ABOUT THIS REPORT

In January 2016, the PRI and UNEP FI, with the generous financial support of The Generation Foundation, launched a four-year project to clarify investor obligations and duties (known in common law markets as fiduciary duties) in relation to the integration of environmental, social and governance (ESG) issues in investment practice and decision making. The project involved working with investors, governments and intergovernmental organisations:

1. To develop and publish an international statement on investor obligations and duties.
2. To prepare policy analysis and research into investor duties across a range of markets, published in country roadmaps.
3. To engage with policy makers and encourage them to adopt policy measures that clarify and formalise that investor duties and obligations incorporate ESG issues in their markets.

This is the final report from that project. It replaces the original 2015 report which found that the “failure to consider all long-term investment value drivers, including ESG issues, is a failure of fiduciary duty”. Despite significant progress, many investors were not fully integrating ESG issues into their investment decision-making processes, necessitating regulatory clarification.

The origins of the modern interpretation of fiduciary duty date back to the landmark 2005 Freshfields Report, commissioned by the United Nations Environment Programme Finance Initiative (UNEP FI) Asset Management Working Group. Whereas there was relatively little change in the law relating to fiduciary duty between 2005 and 2015, there has been a great deal of development in the past few years.

This report describes how the integration of ESG issues into investment practice and decision making is an increasingly standard part of the regulatory and legal requirements for institutional investors, along with requirements to consider the sustainability-related preferences of their clients and beneficiaries, and to report on how these obligations have been implemented. It also identifies areas where further work is required and reflects on how investors’ duties and obligations may further evolve over time.

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# FOREWORDS



*Bruno Le Maire, Minister of the Economy and Finance, France*

## BRUNO LE MAIRE

The world economy is at a crossroads. While climate risk becomes obvious, and populism is gaining traction in many jurisdictions, the involvement of all stakeholders is crucial to shift to an economy more responsible from an environmental and social perspective.

The financial system has a crucial role to play in the shift towards a more sustainable economy – regulators and supervisors cannot act alone. The involvement of the financial sector will be key in channelling capital and fostering investment decisions: without a strong signal from investors, insurers, bankers, no significant change in our economic system will be possible. And it is in the interest of financial firms to engage in the transition, as climate risk or stranded assets may suddenly disrupt their business models.

We welcome the long-time involvement of the PRI initiative in driving this change by gathering an ever-growing number of investors. It was an honour for me to welcome this year's PRI in Person in Paris. France intends to be at the forefront of this challenge, by setting up a comprehensive regulatory toolbox for the development of sustainable finance, while pushing for similar efforts at the European and international level. It is crucial to give corporates and investors the stability they need to integrate long-term considerations into their strategic decisions.

In this view, I welcome the latest report of the PRI and UNEP FI "Fiduciary duty in the 21st century" which puts forward in-depth policy recommendations. The time has come to take bold action in order to mitigate climate change according to the temperature objectives of the Paris Agreement and to achieve the SDGs by 2030. The dialogue between regulators and stakeholders is of the utmost importance in order to draft efficient pieces of legislation which fit the need of all relevant actors. I look forward to working along with you on overcoming those burning challenges and achieving the urgent transition we cannot postpone any further.



*Brian Schatz, United States Senator  
for Hawai'i*

## BRIAN SCHATZ

Climate-related financial risks are not just something that will happen in the distant future: climate change is already increasing the frequency and severity of severe weather events like droughts, floods, and wildfires, and it will drive changes to long-term climate patterns that will be economically devastating. Temperature increases will lower labor productivity and stress agricultural yields. Rising sea levels will devalue and destroy coastal properties. Insurance coverage will be prohibitively expensive or simply not available.

Market participants recognize this reality. Investors increasingly seek opportunities with positive environmental, social, and governance attributes precisely because doing so will maximize returns over the long term. Contrary to the longstanding perception in some circles that ESG investing is associated with a “performance penalty”, we know companies that incorporate sustainability into their business models often outperform those that do not. As climate change impacts every sector of the economy, investors who choose responsible investing will also be choosing investment performance.

This report demonstrates that ESG integration is a component of asset managers’ fiduciary duty. But our financial regulators’ understanding of fiduciary duty also needs to reflect the materiality of ESG issues, particularly the risks posed by climate change. For asset managers to understand the full scope of their clients’ risk exposure, companies need to clearly disclose their own exposure to—and management of—climate-related risks. Financial regulators must mandate consistent and comparable corporate reporting on climate risks and enable fiduciaries to deliver on their duties.

I applaud the authors of this report for highlighting the importance of ESG issues to long-term investment value, and I am working to ensure their recommendations are better reflected in U.S. financial regulation.



*Sharon Hendricks, Chair of the Board,  
CalSTRS*

## SHARON HENDRICKS

As Chair of the Teachers' Retirement Board, my main role is to grow and protect the retirement savings of the 950,000 teachers and their families who are members and beneficiaries of CalSTRS. My fiduciary duty to the CalSTRS members and beneficiaries comes first. This means that every day, as I perform my duties and make decisions as Chair of the Teachers' Retirement Board, my top priority is to guide the system solely for the benefit of CalSTRS members and to do so in a prudent manner.

As a significant investor with a very long-term investment horizon, the success of CalSTRS is linked to global economic growth and prosperity. Actions and activities that detract from the likelihood and potential of that growth are not in the long-term interests of the fund. Because of this, we see integration of environmental, social and governance (ESG) factors into our investment decisions as an integral part of the fulfilment of our fiduciary obligations.

Consistent with our fiduciary responsibilities to our members and beneficiaries, the board has an obligation to require that the corporations and entities in which we invest meet a high standard of conduct and strive for sustainability in their operations.

The PRI's work on sustainable investing has helped CalSTRS further understand the alignment between comprehensive ESG integration and the fulfilment of our fiduciary duty. I hope the following report will help pension fiduciaries in the U.S. and around the world advance their own ESG integration activities and help them see that we all have a role to play in advancing government policies that facilitate ESG integration for our members and beneficiaries and for future generations.



*Hiro Mizuno, Executive Managing Director and CIO, Government Pension Investment Fund*

## HIRO MIZUNO

GPIF's journey in improving the sustainability of our portfolio and the capital market as a whole has never been easy. One of the most contentious points both internally as well as with external stakeholders and asset managers has been the relationship between fiduciary duty and ESG.

We are gradually coming to the realization that a more holistic understanding of fiduciary duty is critical to preserving capital over the long-term. Issues such as climate change or social disruption caused by inequality pose long-term systemic risks that ultimately affect our fund performance, and these risks cannot be hedged away through traditional portfolio diversification. Companies that generate significant negative externalities in pursuit of short-term gains hinder our ability to fulfil our duty as a fiduciary.

Fiduciary duty as a legal concept is defined and interpreted differently depending on the constituency or jurisdiction. As such, there is no one-size-fits-all solution to resolving this debate; each investor needs to do their homework in finding out the best way to address the issue in the context of their own specific situation.

The report on Fiduciary Duty in the 21st Century can be greatly beneficial to many investors in this regard. It provides evidence for investors who are struggling to make headway in convincing sceptics of the financial benefit of sustainable investing. We welcome this report and expect it will be instrumental in facilitating ongoing discussions around ESG and fiduciary duty, and in bringing all asset owners on board in the journey to sustainable investing.

# EXECUTIVE SUMMARY

The fiduciary duties of investors require them to:

- Incorporate environmental, social and governance (ESG) issues into investment analysis and decision-making processes, consistent with their investment time horizons.
- Encourage high standards of ESG performance in the companies or other entities in which they invest.
- Understand and incorporate beneficiaries' and savers' sustainability-related preferences, regardless of whether these preferences are financially material.
- Support the stability and resilience of the financial system.
- Report on how they have implemented these commitments.

There are three main reasons why the fiduciary duties of loyalty and prudence require the incorporation of ESG issues.

## 1. ESG incorporation is an investment norm.

There is now such momentum behind the idea of responsible investment that the PRI has grown to over 2500 signatories, investing \$90 trillion; and it is still growing.

In 2018, the PRI introduced minimum requirements for signatories including an investment policy that covers the investor's responsible investment approach, which must account for more than 50% of assets under management, as well as senior-level commitment and accountability mechanisms for implementation. Ongoing annual disclosures by signatories demonstrate further progress towards the implementation of the Principles by signatories, including disclosure requirements which map to the TCFD.

This tells us that there is convergence between the ideas and motivations of responsible investment and investment. The incorporation of ESG issues into investment analysis and decision-making processes has become a necessary part of investment.

## 2. ESG issues are financially material.

Empirical and academic evidence demonstrates that incorporating ESG issues is a source of investment value. ESG analysis assists investors to identify value-relevant issues. Neglecting ESG analysis may cause the mispricing of risk and poor asset allocation decisions and is therefore a failure of fiduciary duty.

Systemic issues, like climate change, may significantly alter the investment rationale for particular sectors, industries and geographies and may have generalised negative impacts on economic output. Ultimately, the consideration of ESG issues has become one of the core characteristics of a prudent investment process.

## 3. Policy and regulatory frameworks are changing to require ESG incorporation.

Globally, there are over 730 hard and soft-law policy revisions, across some 500 policy instruments, that support, encourage or require investors to consider long-term value drivers, including ESG issues. Policy change has clarified that ESG incorporation and active ownership are part of investors' fiduciary duties to their clients and beneficiaries.

Investors that fail to incorporate ESG issues are failing their fiduciary duties and are increasingly likely to be subject to legal challenge.



## Looking forward

The assumption that ESG issues were not financially material, and so therefore inconsistent with fiduciary duties, is no longer supported. However, further work is required.

First, we must ensure that policy and regulatory change is effectively implemented. This requires quality drafting, oversight and monitoring of policy change, as well as industry capacity building, and disclosure. It also requires policy makers to be accountable for effective implementation, modifying policy where weaknesses are identified.

Second, in jurisdictions lagging on policy change investors must engage policy makers to urgently clarify ESG incorporation requirements, supporting efforts to institutionalise ESG requirements across the investment market as a whole. This is notably the case in the US.

In 2014, the PRI, UNEP FI and our UN partners identified the misinterpretation of fiduciary duties as the primary barrier to ESG incorporation. The Fiduciary Duty in the 21st Century programme sought to “end the debate about whether fiduciary duty is a legitimate barrier to ESG incorporation.” As this final report demonstrates, the programme has contributed a substantial evidence base and promoted policy change to do so.

We would like to thank all our partners, investors, policymakers and stakeholders that we have worked with along the way.

Third and finally, investors and policy makers now need to explore how investors might explicitly incorporate sustainability impacts in investment decision making processes.

Fiduciary duties require ESG incorporation, however capital markets remain unsustainable. As currently defined, the legal and regulatory frameworks within which investors operate require consideration of how ESG issues affect the investment decision, but not how the investment decision affects ESG issues. Changing this will be our next phase of work.



# THE ORIGINS OF FIDUCIARY DUTY

**In the modern investment system, organisations or individuals, known as fiduciaries, manage money or other assets on behalf of beneficiaries and investors. Beneficiaries and investors rely on these fiduciaries to act in their best interests, typically defined exclusively in financial terms.**

In practice, these fiduciaries have discretion as to how they invest the funds they control. The scope of that discretion varies. It may be narrow, for example, in the case of tailored mutual funds where the beneficiary specifies the asset profile and only the day-to-day stock selection and other management tasks are left to the investment decision maker. It may be wide, as with many occupational pension funds. Further, some public funds are subject to considerable state control and the discretion afforded to these decision makers may be further narrowed by parameters set by government.

Within the scope of discretion left to the investment decision maker, fiduciary duties – and equivalent obligations in civil law jurisdictions – exist to ensure that those who manage other people’s money act responsibly in the interests of beneficiaries or investors, as opposed to serving their own interests. These duties are of particular importance in relationships where there is vulnerability (e.g. where there are imbalances in expertise or where the ability of the beneficiary to monitor or oversee the actions of the person or entity acting in their interests is limited), power to act or discretion.

The manner in which these duties are framed differs between countries and between common and civil law jurisdictions (see Box 1).

## Box 1: Common and Civil Law Jurisdictions

**In general terms, jurisdictions use two distinct legal systems** – common law or civil law – with some jurisdictions using a hybrid of the two, and some using additional systems of customary and religious law (for example, a combination of common and civil law exists in South Africa, and civil law in China is influenced by customary law). There are approximately 150 jurisdictions using a civil law system, and 80 using a common law system. Common law systems are administered by decisions made in the courts, typically based on previous court decisions and statutes. These decisions are universally binding until overturned by a higher court or statute. Civil law systems are defined by written codes containing general principles, supplemented by detailed statutes and treat previous court decisions with secondary importance.

**In the common law jurisdictions covered by this report** – Australia, Canada, South Africa, the UK (in respect to England and Wales) and the US – fiduciary duties are the key framework governing the discretion of investment decision makers, aside from any specific constraints imposed contractually or by statute/regulation. These fiduciary duties were originally developed by the courts and some have since been articulated by statute. The courts will interpret the duties when deciding specific cases. Over time, the duties are open to re-interpretation by the courts if new facts and circumstances come to light. The government may also pass new statutes in response to changed circumstances or a particular court decision. In the US, for example, the decision maker's duty is to exercise reasonable care, skill and caution in pursuing an overall investment strategy that incorporates risk and return objectives reasonably suitable to the trust.

**In jurisdictions where civil law applies** – Brazil, China, the EU, France, Germany and Japan – any obligations equivalent to 'fiduciary duties' will be set out in statutory provisions regulating the conduct of investment decision makers and in the governmental and other guidelines that assist in the interpretation of these provisions. The content of each of these statutory provisions differs slightly between jurisdictions and depends on the type of institutional investor, but common themes include:

- Duty to act conscientiously in the interests of beneficiaries – this duty is expressed in various terms, with jurisdictions using expressions such as “good and conscientious manager” (Japan) or “professionally” (Germany).
- Duty to seek profitability.
- Recognition of the portfolio approach to modern investment, either in express terms or implicitly in the form of requirements to ensure adequate diversification.
- Other duties relating to liquidity and limits on the types of assets that may be selected for certain categories of funds.

**In all jurisdictions**, the rules that affect investment decision making take the form both of specific laws (about the assets that are permitted for certain types of investment, and the extent to which the assets of a fund may be invested in specific asset classes or be exposed to particular issuers or categories of issuers, for example) and general duties that must be fulfilled (such as duties to ensure investments are adequately diversified).

While the specific sources of jurisprudence and mechanisms of enforcement differ, there is striking agreement between civil and common law jurisdictions that the most important duties owed by fiduciaries to investors and beneficiaries are the duty to act prudently and the duty to act in accordance with the purpose for which investment powers are granted (also known as the duty of loyalty). These traditional duties are presented in Box 2.

## Box 2: Traditional Fiduciary Duties

Fiduciary duties (or equivalent obligations) exist to ensure that those who manage other people's money act in the interests of beneficiaries and do not serve their own interests. The most important of these duties are:

- **Loyalty:** Fiduciaries should act honestly and in good faith in the interests of their beneficiaries, should impartially balance the conflicting interests of different beneficiaries, 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.

These principles require fiduciaries to concern themselves with risks, trends, innovation and the future, both in the short term and over the long term (which in the case of pension funds may be many decades). Fiduciary duty itself is not a static concept. It evolves and adjusts in response to changes in knowledge, market practices and conventions, regulations and policies, and social norms.

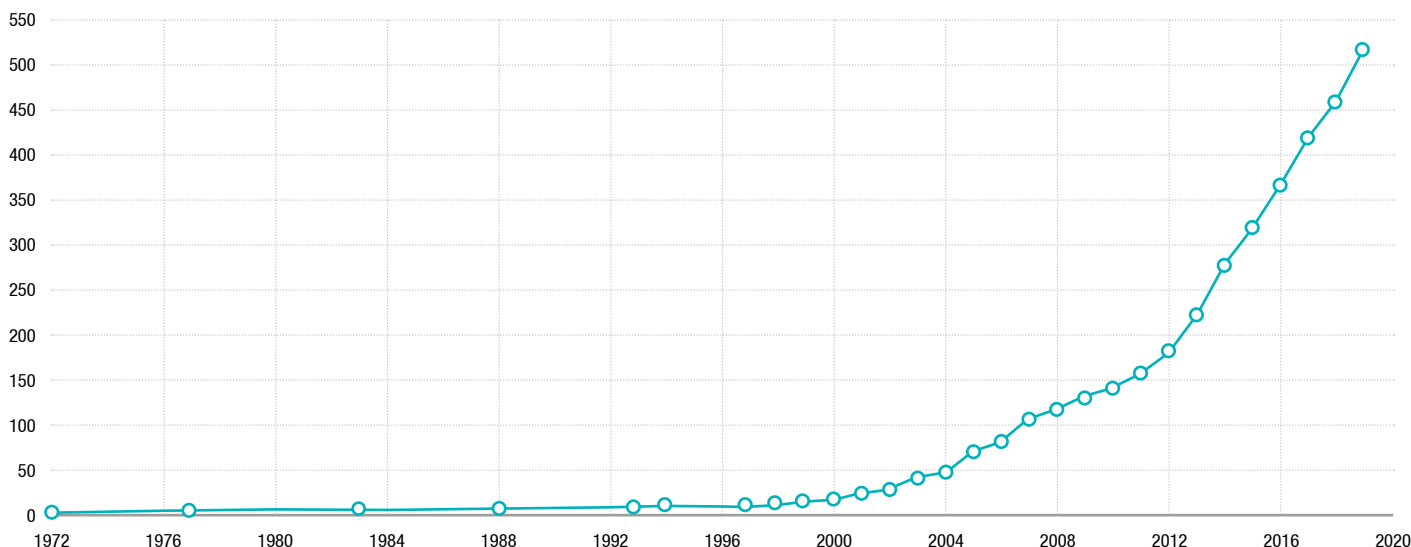
As we discuss in the next three sections, there has been a dramatic change in the investment landscape in recent years. The argument that environmental, social and governance issues are important drivers of investment value is widely accepted. The integration of environmental, social and governance issues into investment practices and processes, and into company engagement is increasingly seen as established practice. Critically, many jurisdictions are now starting to formalise these practices as standard expectations of all investors.

# THE NEW POLICY CONTEXT

Across the world’s 50 largest economies, there are now over 730 hard and soft law policy revisions across the 500 policy instruments that support investors in their consideration of long-term value drivers, including ESG factors.<sup>1</sup> Forty-eight of the top 50 economies now have some form of policy designed to help investors consider sustainability risks, opportunities or outcomes.

The introduction of regulation and policy relating to ESG and responsible investment is very much a 21st century phenomenon.<sup>2</sup> Of the hard and soft law instruments identified in PRI’s Responsible Investment Database,<sup>3</sup> 97% were developed after the year 2000. As illustrated in Figure 1, the rate of adoption has accelerated in recent years.<sup>4</sup>

**Figure 1. The growth in responsible investment regulation and policy**



Source: PRI Responsible Investment Regulation database

These policy instruments can be divided into three broad categories:

- 1. Pension fund regulations** (focusing on asset owners) – The most common types of pension fund regulations have been: (a) disclosure requirements, where pension funds are required to disclose their responsible investment commitments and/or how these commitments have been implemented; and (b) regulations encouraging pension funds to adopt responsible investment practices. Some examples are presented in Figure 3.
- 2. Stewardship codes** (focusing on asset managers and asset owners) – These codes govern or steer the interactions between investors and investee companies, with a view to promoting long-term value creation strategies.
- 3. Corporate disclosures** (focusing on individual companies, primarily publicly listed companies) – These include requirements to discuss ESG issues in annual reports and accounts, and requirements to provide disclosures on specific ESG issues.

1 See <https://www.unpri.org/sustainable-markets/regulation-map>.  
 2 In 2000, the UK introduced the world’s first regulation requiring disclosure by occupational pension funds of their policies on environmental, social and governance issues. For a useful historic perspective, see Sparkes, R. (2002), *Socially Responsible Investment: A Global Revolution* (Wiley).  
 3 See <https://www.unpri.org/sustainable-markets/regulation-map>.  
 4 For example, the world’s first Stewardship Code was introduced in the UK in 2010.

**Figure 2. Examples of policy instruments promoting sustainable investment by pension funds**

Country	Title	Date	Relevant Text
UK	The Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018	2019	<p>“Appropriate time horizon” means the length of time that the trustees of consider necessary for the funding of future benefits by the investments of the scheme;</p> <p>“Financially material considerations” includes (but is not limited to) environmental, social and governance considerations (including but not limited to climate change), which the trustees of the trust scheme consider financially material.</p>
EU	Proposal for a Regulation of the European Parliament and of the Council on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341	2019	<p>Financial market participants shall include descriptions of the following in precontractual disclosures:</p> <ul style="list-style-type: none"> <li>(a) the procedures and conditions applied for integrating sustainability risks in investment decisions;</li> <li>(b) the extent to which sustainability risks are expected to have a relevant impact on the returns of the financial products made available;</li> <li>(c) how the remuneration policies of financial market participants are consistent with the integration of sustainability risks and are in line, where relevant, with the sustainable investment target of the financial product.</li> </ul>
US	EBSA: Field Assistance Bulletin No. 2018-01	2018	<p>“To the extent ESG factors, in fact, involve business risks or opportunities that are properly treated as economic considerations themselves in evaluating alternative investments, the weight given to those factors should also be appropriate to the relative level of risk and return involved compared to other relevant economic factors.”</p>
Brazil	Resolution 4661	2018	<p>Resolution n.4661/2018 states that, in their risk analysis processes, pension funds shall consider the environmental, social and corporate governance aspects, whenever possible, in addition to the economic sustainability analysis. This recommendation was enhanced by “Instrução Previc n. 6/2018”, which states that pension funds’ investment policies shall include guidelines for complying with environmental, social and governance issues, preferably by economic sector.</p>
EU	Directive (EU) 2016/2341 of the European Parliament and of the Council of 14/12/2016 on the activities and supervision of institutions for occupational retirement provision (IORPs)	2016	<p>“The system of governance shall include consideration of environmental, social and governance factors related to investment assets in investment decisions, and shall be subject to regular internal review.”</p>
Ontario, Canada	Pension Benefits Act	2016	<p>Under section 78(3), a plan’s statement of investment policies and procedures (SIPP) is required to include information as to whether environmental, social and governance (ESG) factors are incorporated into the plan’s investment policies and procedures and, if so, how those factors are incorporated.</p>
Korea	National Pension Service Act	2015	<p>The National Assembly passed amendments to the National Pension Act of Korea, which requires NPS to consider ESG issues and to declare the extent to which ESG considerations are taken into account.</p>
Australia	SPG 530	2013	<p>APRA expects that a registrable superannuation entity (RSE) licensee would have a reasoned basis for determining that the investment strategy formulated for such an investment option is in the best interests of beneficiaries, and that it satisfies the requirements of s.52 of the SIS Act for liquidity and diversification. While ESG considerations may not be readily quantifiable in financial terms, APRA expects an RSE licensee would be able to demonstrate appropriate analysis to support the formulation of an investment strategy that has an ESG focus.</p>
South Africa	Pension Fund Act	2013	<p>The Pension Fund Act codifies fiduciary duty and states that it applies to trustees of pension funds. Sections 7(c) and (d) cover the duties (avoiding conflicts, duty of care, diligence, good faith and independence). In 2011, Regulation 28 was revised to require an investment process for which trustees are responsible for developing with respect to the funds circumstance and monitoring. It requires funds to consider all factors (including ESG) that may be relevant to its long-term success.</p>

Source: PRI Responsible Investment Regulation databasea

These policies have played an important role in encouraging investors to take action on ESG issues and to report on the actions that they have taken. They have also, through improving corporate disclosures, helped address some of the key barriers to the integration of ESG issues into investment research and decision-making processes.

Despite this progress, more needs to be done to ensure the effective implementation of these policies. Our work, as described in the country case studies, identifies different factors. In many cases, the issue is that the policies are either voluntary (e.g. many of the stewardship codes) or ‘comply or explain’ (where non-compliance is permitted so long as investors explain why they do not comply). In other cases, the formal obligations are relatively weak. For example, the 2016 Canada Pension Benefits Act, requires pension plans to publish information as to “whether ESG factors are incorporated into the plan’s investment policies” and, if so, how those factors are incorporated. Finally, the level of resources and attention paid to the quality of implementation remains mixed in many jurisdictions. In many cases, it is because this legislation is relatively new and, therefore, more time is needed before the quality of implementation can be properly assessed.

In jurisdictions where regulations or policies on responsible investment are more mature, these issues are starting to be addressed. Regulators are extending the concept of ‘comply or explain’ to require investors to explain how they propose to address non-compliance. In other cases, regulators are introducing new policies designed to remove ambiguity around the relationship between sustainability and finance. For example, the 2019 EU investor disclosures regulation requires investors to disclose how sustainability risks are integrated into investment processes. In parallel, the EU is working to amend the rules underpinning key sectoral legislation (such as MiFID II and Solvency II) to clarify that sustainability should be considered by an investor in the fulfilment of their duties.

These changes in investors’ duties and in financial system regulations are not occurring in a vacuum. Policy makers, regulators and governments recognise that issues such as climate change and sustainable development represent systemic risks and opportunities that require explicit and targeted interventions. Many countries have started to implement the Paris Climate Agreement<sup>5</sup> and the Sustainable Development Goals<sup>6</sup> in national policy and regulations. While the details differ, domestic policies generally involve the setting of national targets, the development of national policy plans and implementation programmes, the adoption of regulation and other policy instruments (e.g. economic instruments and self-regulation), the allocation of responsibilities to different actors and the creation of incentives for action. Some governments have formally incorporated sustainability into the mandates of their financial regulators.

Many of these strategies – see Box 3 for examples – now explicitly focus on the finance sector, recognising that the capital required to deliver policy commitments on climate change and development cannot be delivered by governments alone and that decisions made in the financial system influence the sustainability of the real economy. This integration of finance into sustainability policy, and the integration of sustainability considerations into finance policy, suggest that we are moving towards a much more integrated and aligned approach to policy across these two areas.

This trend towards alignment and integration is reinforced by other changes. For example, at a multilateral level, the central banks’ Network for Greening the Financial System acknowledged in April 2019 that climate change is a source of financial risk. With support from the World Bank, finance ministers from more than 20 countries launched, in April of 2019, a coalition to promote climate action through mainstream financial policies at a national level. In early 2019, IOSCO, the international securities regulators organisation, and IOPS, the international pensions supervisors organisation, launched consultations on ESG integration and disclosure for listed companies and pension fund regulators.

<sup>5</sup> See [http://unfccc.int/paris\\_agreement/items/9485.php](http://unfccc.int/paris_agreement/items/9485.php).

<sup>6</sup> See <http://www.un.org/sustainabledevelopment/sustainable-development-goals/>.

### Box 3: Examples of integrated finance and sustainability policies

In 2016, the People's Bank of China, in collaboration with six other government agencies, issued guidelines establishing the green financial system.<sup>7</sup> The guidelines include proposals on:

- Developing green lending.
- Enhancing the role of the securities market through improving the rules and regulations for green bonds and guiding international investors to invest in green assets.
- Launching green development funds and public private partnerships.
- Developing green insurance.
- Improving and extending environmental rights trading markets.

In France, the energy transition law of 2015 set long-term goals to reduce GHG emissions and energy consumption, improve buildings' energy efficiency and increase renewable energies. The law on energy and the climate, prepared in 2019, outlines a new set of long-term goals to achieve carbon neutrality by 2050. The French government has also been developing strategies and a shared framework to achieve more sustainable growth, including biodiversity protection, a circular economy and a social solidarity economy sector.<sup>8</sup>

In the UK, climate change is embedded in a number of long-term economic goals and strategies. The UK government committed to reducing its greenhouse gas emissions to net zero by 2050. The Clean Growth Strategy adopted in 2017 aims to deliver increased economic growth while cutting emissions. The UK Green Finance Strategy adopted in 2019 seeks to align private sector financial flows with clean, environmentally sustainable and resilient growth while strengthening the competitiveness of the UK financial services sector.<sup>9</sup>

These policy interventions can materially alter the economics of the decisions that companies and investors make. They mean that investors need to pay attention to the changes that these measures catalyse (e.g. the economics of specific investments may shift, and certain companies may find that they need to change their business models). They also mean that investors need to pay attention to the likely future investment trajectories, and consider whether and how incentives will change over time. This may lead to an adjustment of the assessment of the financial characteristics of particular assets or investments and lead investors to potentially take action (e.g. changing investment holdings, company engagement) to minimise downside risk or take advantage of opportunities.

Ultimately, this new policy context – one that is seeing the increased codification of investors' ESG-related obligations and increased integration of financial and sustainability-related policy – removes any ambiguity or doubt about how fiduciary duties are to be interpreted in practice. We have moved from a world where investors' duties relating to ESG and sustainability-related issues were implied and implicit, to one where they are explicitly described in legislation and regulations.

<sup>7</sup> See also the China snapshot in the Country section of this report.

<sup>8</sup> See also the France snapshot in the Country section of this report.

<sup>9</sup> See also the UK snapshot in the Country section of this report.



# THE FINANCIAL AND INVESTMENT RELEVANCE OF ESG ISSUES

The previous section demonstrated that changing policy frameworks have removed ambiguity around ESG issues as a core part of an investor's fiduciary duty. In this section we discuss the financial and investment relevance of ESG, presenting evidence that ESG issues can be important drivers of investment performance and that investors use this data to create value in their investment portfolios.

There is now a compelling body of evidence that ESG issues can drive investment value and/or that the failure to effectively manage ESG issues can destroy investment value. The key arguments in support of this statement include:

- **There is a positive correlation between ESG and corporate financial performance** – The 2014 paper 'The Impact of Corporate Sustainability on Organisational Processes and Performance' by Robert Eccles et al. investigated the long-term effect of corporate sustainability on organisational processes and performance.<sup>10</sup> Using a matched sample of 180 US companies, the paper found that corporations that had voluntarily adopted sustainability policies significantly outperformed those that had adopted almost none of these policies – termed 'low sustainability' companies. The paper also suggested that these high sustainability firms generated significantly higher stock returns, signifying that indeed the integration of such issues into a company's business model and strategy may be a source of competitive advantage in the long run.
- **Companies with better ESG performance can have better access to finance** – In their paper 'Corporate Social Responsibility and Access to Finance' (2014), Cheng et al. found that firms with better corporate social responsibility (CSR) performance, better stakeholder engagement and better transparency on ESG issues faced significantly lower capital constraints.<sup>11</sup>
- **There are significant investment opportunities associated with ESG issues** – For example, it is estimated that between now and 2030, between USD 5 and USD 7 trillion a year is needed if we are to achieve the Sustainable Development Goals worldwide.<sup>12</sup> A least a further USD 1.5 trillion a year is needed in the same period to meet the Paris goal of keeping the average global temperature rise well below 2 degrees Celsius and as close as possible to 1.5 degrees Celsius.<sup>13</sup>

<sup>10</sup> Eccles, R., Ioannou, I. and Serafeim, G. (2014), 'The Impact of Corporate Sustainability on Organizational Processes and Performance', *Management Science*, Vol. 60, Issue 11, pp. 2835–2857. Available at: <https://doi.org/10.1287/mnsc.2014.1984>. See also University of Oxford and Arabesque Partners (2015), *From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance* (March 2015). Available at: [https://arabesque.com/research/From\\_the\\_stockholder\\_to\\_the\\_stakeholder\\_web.pdf](https://arabesque.com/research/From_the_stockholder_to_the_stakeholder_web.pdf).

<sup>11</sup> Cheng, B., Ioannou, I. and Serafeim, G. (2014), 'Corporate Social Responsibility and Access to Finance', *Strategic Management Journal*, Vol. 35, Issue 1, pp. 1–23. Available at: <https://onlinelibrary.wiley.com/doi/abs/10.1002/smj.2131>. Similar conclusions were drawn by El Ghoul, S., Guedhami, O., Kwok, C. and Mishra, D. (2011), 'Does Corporate Social Responsibility Affect the Cost of Capital?', *Journal of Banking and Finance*, Vol. 35, Issue 9, pp. 2388–2406. Available at: [https://econpapers.repec.org/article/eeejbfina/v\\_3a35\\_3ay\\_3a2011\\_3ai\\_3a9\\_3ap\\_3a2388-2406.htm](https://econpapers.repec.org/article/eeejbfina/v_3a35_3ay_3a2011_3ai_3a9_3ap_3a2388-2406.htm).

<sup>12</sup> See <http://www.unepfi.org/positive-impact/principles-for-positive-impact-finance/>.

<sup>13</sup> See <https://cop23.unfccc.int/news/bridging-climate-ambition-and-finance-gaps>.

- **The consequences of failing to effectively manage ESG-related risks can be significant** – For example, one analysis of the financial costs of corporate fines and settlements shows that the ten largest fines and settlements in corporate history together amount to USD 45.5 billion, that banks have paid out USD 100 billion in US legal settlements alone since the start of the financial crisis and that global pharmaceutical companies have paid USD 30.2 billion in fines since 1991.<sup>14</sup> Individual incidents and events can also have major impacts on corporate value. For example, the share prices of Vale S.A. fell by almost a quarter in the immediate aftermath of the Brumadinho mine disaster in 2019, and Volkswagen AG lost almost a quarter of its market value in 2015 after it admitted to cheating on US air pollution tests for years. In 2015, the share price of the oil multinational BP plc more than halved following the Deepwater Horizon spill.
- **Firms with good ESG ratings on material issues outperform those with poor ratings** – Khan et al., in their 2016 paper ‘Corporate Sustainability: First Evidence on Materiality’, found that firms with good ratings on material sustainability issues significantly outperformed those with poor ratings on these issues. They also found that firms with high ratings on immaterial sustainability issues did not significantly outperform firms with low ratings on the same issues.<sup>15</sup>

The question of whether investors will, in fact, take account of these insights in their investment processes can be separated into distinct elements. The first is whether investors will be motivated to act if the evidence is compelling. A May 2018 CFA Institute survey on ESG integration is perhaps the key starting point for this.<sup>16</sup> With a focus on the US market, the paper concluded that a proven link between ESG factors and financial performance would be among the top motivating reasons for those US investors that have not yet adopted ESG integration in their investment practices to do so.

In addition to the evidence presented above, a 2018 PRI study used ESG data provided by MSCI ESG Research tested a momentum strategy (improving ESG scores) and tilt strategy (high absolute ESG scores) across the world.<sup>17</sup> The study concluded that ESG information offers investment outperformance advantages relative to respective benchmarks across all regions. For example, it concluded that, in the world portfolio, the ESG momentum and tilt

strategies outperformed the MSCI World Index by 16.8% and 11.2% in active cumulative returns respectively over a ten-year period.

These general findings are confirmed by two other studies. In June 2017, BofA Merrill Lynch Global Research released information concluding that the stocks in its US portfolio that ranked within the top third by ESG scores (using ESG research from Thomson Reuters) outperformed stocks in the bottom third by 18 percentage points in the 2005 to 2015 period.<sup>18</sup> A 2015 study from Calvert Research and Management provided similar findings for fixed income.<sup>19</sup> It concluded that companies ranked in the top half compared to bottom half of entities by aggregate ESG scores and by individual environmental, social and governance scores (using data from Reuters) delivered significant outperformance as measured by the annual rate of change in CDS spreads. These results appear to statistically validate the value proposition of investing in the credit of companies with superior ESG profiles.

The second is whether it is feasible – from a cost perspective and a practical perspective – for investors to analyse and assess these issues. Over the past decade, there has been a significant increase in the quantity and quality of data provided by companies on their ESG performance, and the quality and quantity of research on the investment implications of ESG issues; a variety of actors (including financial data providers, research firms, proxy voting agencies and specialist ESG data providers and research organisations) provide high-quality ESG data at scale.

The third is whether a focus on ESG issues enables investors to generate better investment performance. There are now many examples and case studies of how investors have researched and benefited from analysing ESG issues as an integral part of their investment processes.<sup>20</sup> A 2015 study by Fried et al. provides a more comprehensive analysis of investment performance in practice.<sup>21</sup> It analysed more than 2,000 empirical studies on the relationship between ESG criteria and investment performance dating back to the 1970s. The paper concluded that there is a well-established empirical evidence base to support the business case for analysing ESG in investment research and decision making. It notes that approximately 90% of studies find a non-negative relationship between ESG performance and corporate financial performance, with the large majority of studies reporting positive findings.

14 University of Oxford and Arabesque Partners (2015), *From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance* (March 2015). Available at: [https://arabesque.com/research/From\\_the\\_stockholder\\_to\\_the\\_stakeholder\\_web.pdf](https://arabesque.com/research/From_the_stockholder_to_the_stakeholder_web.pdf).

15 Khan, M., Serafeim, G. and Yoon, A. (2016), ‘Corporate Sustainability: First Evidence on Materiality’, *The Accounting Review*, Vol. 91, Issue 6, pp. 1697–1724. <http://www.aajournals.org/doi/abs/10.2308/accr-51383>.

16 <https://www.unpri.org/investor-tools/the-cfa-institutes-esg-survey/2739.article>

17 Nguyen-Taylor, K. and Martindale, M. (2018), *Financial Performance of ESG Integration in US Investing (Principles for Responsible Investment, London)*. Available at: <https://www.unpri.org/download?ac=4218>.

18 Subramanian et al. (2017), *ESG Part II: A Deeper Dive (BofA Merrill Lynch Global Research)*. Available at: <https://www.bofam.com/en-us/content/esg-investing-research-report.html>.

19 Kim Nguyen-Taylor, K., Naranjo, A. and Roy, C. (2015), *The ESG Advantage in Fixed Income Investing: An Empirical Analysis (Calvert Investments)*. Available at: <https://www.environmental-finance.com/assets/files/WP10011.pdf>.

20 The CFA Institute and the Principles for Responsible Investment have produced a series of reports comprising guidance and case studies on how investors can analyse and integrate ESG issues into their investment research and decision-making processes. See, for example, CFA and PRI (2018), *Guidance and Case Studies for ESG Integration: Equities and Fixed Income*, and associated regional reports for the Americas, for Asia Pacific, and for Europe, the Middle East and Africa. These are all available at: <https://www.unpri.org/investor-tools/esg-integration-in-asia-pacific-markets-practices-and-data/4452.article>. The PRI also produces guidance and case-studies on ESG integration in other asset classes, available at: <https://www.unpri.org/investor-tools>.

21 Friede, G., Busch, T. and Bassen, A. (2015), ‘ESG and Financial Performance: Aggregated Evidence from more than 2000 Empirical Studies’, *Journal of Sustainable Finance & Investment*, Vol. 5, Issue 4, pp. 210–233. Available at: <https://www.tandfonline.com/doi/full/10.1080/20430795.2015.1118917>.

# THE CHANGING LANDSCAPE OF INVESTMENT PRACTICE

The previous two sections made the case that investors should integrate ESG issues into their investment research and decision-making processes because of the legal requirements to do so and the evidence that the analysis of ESG issues can drive investment performance. In this section, we examine whether investors actually integrate ESG issues into their investment processes. We find that they do. In turn, this creates a normative expectation that ESG issues are a core part of financial markets.

As of September 2019, the PRI had over 2,500 signatories representing USD 86.3 trillion in AUM, including 465 asset owners and 1,823 asset managers. The PRI's signatories commit to incorporating ESG issues into their investment analysis and decision-making processes, acting as active owners and incorporating ESG issues into their ownership policies and practices, and reporting on their activities and progress towards implementing the principles. These are not just high-level commitments but are being translated into concrete action across the investment system:

- **Investors are increasing their allocations to ESG indices** – MSCI reports that the equity assets under management invested in ESG ETFs linked to MSCI's ESG indices has increased from USD 1.7 billion to USD 20.2 billion over the period 2015 to June 2019.<sup>22</sup>
- **The number of investment products linked to ESG or sustainability themes is growing rapidly** – Morningstar reports that, at the end of 2018, there were over 350 open-end and exchange-traded sustainability themed funds, including equity, fixed income and alternative funds, available to US investors.<sup>23</sup> The number of funds has increased by almost 50% compared to 2017.
- **Investors are accessing and using ESG data** – Bloomberg reports that the number of users of ESG data on its terminals has more than tripled over the period 2012 to 2018.<sup>24</sup>
- **Asset owners are demanding that asset managers pay attention to ESG issues** – In the 2019 PRI Reporting and Assessment framework, 69% of asset owners stated that they include ESG-related factors when appointing asset managers, and 62% stated that they consider ESG-related factors in all stages of asset manager selection, appointment and monitoring.
- **Investors are paying attention to ESG in all asset classes** – The 2018 PRI Reporting and Assessment framework indicated that USD 38 billion of assets in listed equity had some form of ESG integration (e.g. analysis of ESG issues as an integral part of the investment process, screening or thematic investment). Data also showed that there is increasing attention to ESG in other asset classes; for example, 76% of asset owners reported that they consider ESG issues when investing in hedge funds, an increase from 53% in 2017.
- **Sustainable investment is increasingly a standard investment practice:** The Global Sustainable Investment Alliance analysed investment funds across Europe, the United States, Canada, Japan, Australia and New Zealand and identified \$30.7 trillion of funds with some sustainability characteristics, a 34% increase in two years.<sup>25</sup>

<sup>22</sup> MSCI, September 2019.

<sup>23</sup> Morningstar (2019), Sustainable Funds U.S. Landscape Report. Available at: <https://www.morningstar.com/lp/sustainable-funds-landscape-report>.

<sup>24</sup> Available at: <https://www.bloomberg.com/impact/products/esg-data/>.

<sup>25</sup> Global Sustainable Investment Alliance (2018), 2018 Global Sustainable Investment Review, [http://www.gsi-alliance.org/wp-content/uploads/2019/06/GSIR\\_Review2018F.pdf](http://www.gsi-alliance.org/wp-content/uploads/2019/06/GSIR_Review2018F.pdf)

- Active ownership (engagement and voting) is now widely practised** – For example, more than 360 investors from across dozens of countries, collectively managing more than USD 34 trillion in assets, support Climate Action 100+, a collaborative investor initiative to ensure the world’s largest corporate greenhouse gas emitters take necessary action on

climate change.<sup>26</sup> Other examples include the 477 investors representing more than USD 34 trillion in assets who signed a letter calling upon G20 leaders to support the climate disclosure recommendations from the FSB Task Force on Climate-related Financial Disclosures,<sup>27</sup> and the more than 500 investors that support the CDP’s annual disclosure requests.<sup>28</sup>

### Box 4: How do investors interpret their fiduciary duties?

In 2019, as part of the annual reporting and assessment framework, the PRI asked signatories to discuss how they interpret their fiduciary (or equivalent) duties.

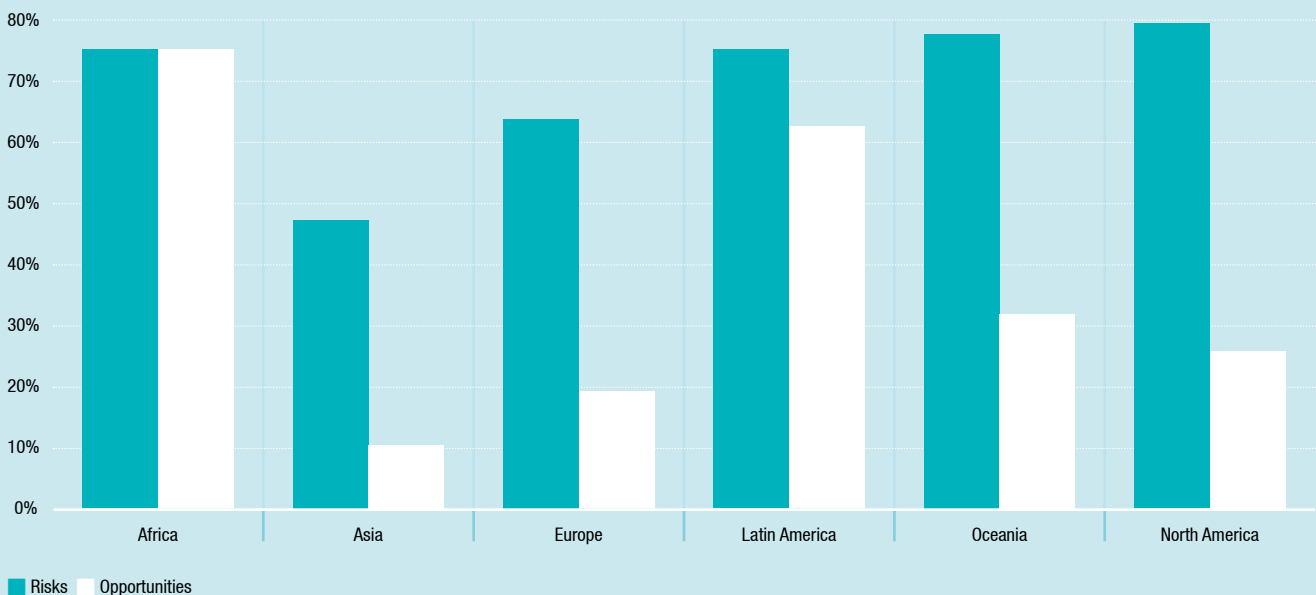
Over 90% of the respondents explicitly acknowledged the consideration of ESG issues in their investment processes as component of their fiduciary duties.

The vast majority of these regarded the consideration of ESG factors as a necessary and important part of fulfilling their fiduciary duty towards their clients or beneficiaries. A smaller number noted that this duty “allowed” or “permitted” them to take account of ESG issues where relevant, and a minority (around 3%) perceived fiduciary duty as a constraint to the consideration of ESG in some circumstances.

For most, the analysis of ESG issues was seen as enabling better risk management or the avoidance of downside risk; less than half highlighted the investment opportunities (or upside) associated with such an analysis (see Figure 3 below).

Stewardship activities such as engagement and voting were identified by close to 40% of respondents as an important way of enhancing value and of delivering on their fiduciary duty.

**Figure 3. Do investors focus on ESG-related risks or opportunities?**



<sup>26</sup> Available at: <http://www.climateaction100.org/>.

<sup>27</sup> Available at: <https://www.fsb-tcfd.org/support-additional-initiatives/>.

<sup>28</sup> Available at: <https://www.cdp.net/en>.

# MODERN FIDUCIARY DUTY

The key conclusion from the evidence presented in the previous sections is that there have been fundamental changes in the expectations of fiduciaries. In summary, fiduciaries must:

1. Incorporate financially material ESG factors into their investment decision making, consistent with the timeframe of the obligation.
2. Understand and incorporate into their decision making the sustainability preferences of beneficiaries/clients, regardless of whether these preferences are financially material.
3. Be active owners, encouraging high standards of ESG performance in the companies or other entities in which they are invested.
4. Support the stability and resilience of the financial system.
5. Disclose their investment approach in a clear and understandable manner, including how preferences are incorporated into the scheme's investment approach.

These expectations both align with and clarify the traditional duties of loyalty and prudence. Understanding and taking account of the sustainability preferences of beneficiaries/clients, whether these preferences are financially material or not, is clearly a central element of the duty of loyalty. Similarly, any conception of prudence (i.e. acting with due skill, care and diligence) clearly includes requirements both to consider all financially material factors and to act effectively and appropriately to manage these factors. The interests of beneficiaries frequently extend many decades into the future, requiring fiduciaries to pay attention to issues such as demographic change, climate change and other environmental pressures.

These expectations are now sufficiently mature and underpinned by legislation and policy; they can – and should – be considered central elements of the duties owed by fiduciaries and their beneficiaries. In Box 5, we present our modern definition of fiduciary duty.

## Box 5: Modern Fiduciary Duty

Fiduciary duties (or equivalent obligations) exist to ensure that those who manage other people's money act in the interests of beneficiaries, rather than serving their own interests. The most important of these duties are:

- Loyalty – Fiduciaries should:
  - Act honestly and in good faith in the interests of their beneficiaries or their clients.
  - Understand and incorporate into their decision making the sustainability preferences of beneficiaries and/or clients, whether or not these preferences are financially material.
  - Impartially balance the conflicting interests of different beneficiaries and clients.
  - Avoid conflicts of interest.
  - Not act for the benefit of themselves or third parties.
- Prudence – Fiduciaries should act with due care, skill and diligence, investing as an 'ordinary prudent person' would. This includes:
  - Incorporating financially material ESG factors into their investment decision making, consistent with the timeframe of the obligation.
  - Being an active owner, encouraging high standards of ESG performance in the companies or other entities in which they are invested.
  - Supporting the stability and resilience of the financial system.

Fiduciaries should disclose their investment approach to clients and/or beneficiaries including information on how preferences are incorporated into the scheme's investment strategy and the potential risks and benefits of doing so.

# NEXT STEPS

The conceptual debate around whether ESG issues are a requirement of investor duties and obligations is now over. However, further work is required in four areas.

The first is to fill the gaps that remain in policy frameworks. While many countries have adopted at least one policy measure, the country analysis presented hereafter confirms that most have yet to establish comprehensive policy frameworks that include pension fund disclosure requirements and responsible investment practices, stewardship codes and corporate disclosure requirements. The particular case of the United States is highlighted in Box 6. In these jurisdictions, investors have an important role to play in pressing for change, and in supporting efforts to institutionalise these requirements across the investment market as a whole.

The second is to ensure that policy and regulation are implemented effectively and translated into concrete actions. This will involve building capacity and awareness across the investment industry and encouraging asset owners and asset managers to implement these measures. It will involve persuading investors to be transparent about the actions they have taken, the outcomes they have achieved and the lessons they have learned. It also requires that policy makers ensure the effective implementation of the policies and other measures they have adopted, and identify and take action where there are weaknesses in adoption or implementation.

## Box 6: US Policy Engagement

With a GDP of USD 21 trillion, USD 32 trillion in equity market capitalisation and USD 43 trillion in outstanding fixed income securities, the US has the largest economy and the largest financial markets of any country in the world.

The US is the PRI's largest market, with 490 signatories investing over USD 42 trillion in assets under management.

Confusion among investors about the nature of their fiduciary obligations is often cited as a major barrier to investors' integration of ESG factors into investment decisions.

In 2018, DOL released a Field Assistance Bulletin (FAB), that created confusion for fiduciaries of private sector pension plans. The FAB reiterated DOL's longstanding position that fiduciaries are obliged to consider ESG factors as part of investment decisions "[t]o the extent ESG factors, in fact, involve business risks or opportunities that are properly treated as economic considerations themselves". At the same time, the DOL stated that fiduciaries "must avoid too readily treating ESG issues as being economically relevant to any particular investment choice". While the FAB did not reflect a substantive change to the DOL's position that material economic factors, including ESG factors, are to be considered by investment fiduciaries, the explanatory language in the Bulletin created uncertainty for fiduciaries of private pension plans.

The PRI will continue to engage with signatories to facilitate understanding of the applicability and impact of the DOL Bulletin and explore whether it is appropriate to advocate for policy changes that will provide greater clarity for fiduciaries.

The third is to recognise that discussions about the duties and obligations of investors are not confined to investors (asset owners, asset managers, insurance companies, etc.) themselves but require that other actors in the investment system play a role. For example, investment consultants provide counsel on the investment practices of trillions of dollars worldwide. They are a recognised source of authority and knowledge on investment practice, and their advice shapes the beliefs and practices regarding trillions of dollars of invested assets worldwide. The views that investment consultants hold about ESG factors therefore have major implications for the sustainability of the financial system. However, there currently seems little commercial imperative for investment consultants to extend the coverage of ESG integrated services for their clients.

Another example relates to defined benefit pension schemes. In some cases, regulators have been clear that fiduciary or other duties continue to apply (e.g. in South Africa). However, in other markets the nature of the duty to beneficiaries of insurance companies, investment managers and sponsoring organisations in contract-based schemes (i.e. where the pension provider does not have fiduciary or equivalent obligations to the beneficiary in the way that a trustee would in a trust-based scheme) is not yet fully defined.

These examples highlight the importance of ensuring that regulatory and policy changes reflect the realities of investment markets and the investment system. Regulation and policy need to apply to all relevant actors, and to be sufficiently flexible to adapt in response to changes in actors, in institutions, in technology and in the wider societal context within which the investment system functions.

The fourth is that we need to understand how and under what circumstances investors are responsible for the real-world outcomes of their investment activities. Integrating consideration of ESG issues into investment practices and processes is a necessary but insufficient condition to delivering a financial sector that serves societies and individuals within existing planetary boundaries. As currently defined, fiduciary duties do not require a fiduciary to account for the sustainability impact of their investment activity beyond financial performance. In other words, fiduciary duties require consideration of how sustainability issues affect the investment decision, but not how the investment decision affects sustainability. More fundamental changes – to incentives, to structures, to duties, to obligations and to the broader legal frameworks within which investors operate – are needed if the financial sector is to enable economic activities and societies to prosper in a sustainable manner. Wider public policy, more explicitly on real-economy outcomes, is the key next step in moving towards a more sustainable economy.

# COUNTRY ANALYSIS



For Canada to be competitive in a world that is increasingly concerned about sound environmental stewardship, sustainable finance needs to become business as usual in the Canadian financial services industry.

*Tiff Macklem, Chair of the Expert Panel on Sustainable Finance, Canada*

New regulations commit UK occupational pension schemes for the first time to clearly and openly explain how they take account of Environmental, Social and Governance considerations, including climate change.

*Guy Opperman, UK Pensions Minister*



Fundamentally, the history of securities law shows that we will need mandatory rules to address ESG issues. Voluntary disclosures on a case-by-case basis produce a selection effect where only the least problematic companies will change, which is why mandatory disclosure is the basic bargain of participating in our markets. One-off disclosures produce information investors cannot compare across companies and industries, making it harder to hold corporate managers accountable. It is vital that we bring more transparency to these crucial sustainability issues in time to do something meaningful about them.

*Robert Jackson, US SEC Commissioner*

The Paris Agreement on climate change is not just an environmental treaty but offers the basis for a new and inclusive model of development. France is committed to making finance a driving force behind this transition.

*Brune Poirson, Secretary of State, Ministry for the Ecological and Inclusive Transition, France*

Supervisors in each jurisdiction need to explicitly clarify that ESG integration is fully in line with pension funds' fiduciary duties.

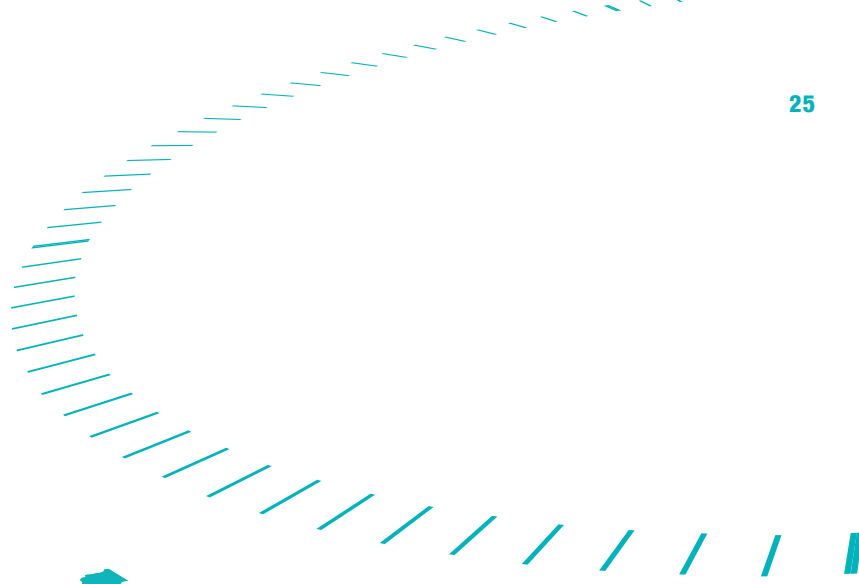
*André Laboul, Secretary General, International Organisation of Pension Supervisors (IOPS)*



Previc has incorporated the need for pension funds to consider environmental, social and governance aspects in their investment risk analysis into current regulations, whenever possible, as well as the need to comply with these guidelines in the investment policy

*Resolution CMN n. 4661 and Instruction Previc n.6*





We do not need economic growth for the sake of growth but for the sake of well-being of people. This means taking social and environmental factors into account.

*Valdis Dombrovskis, EU Commissioner*

As a universal owner, instead of trying to beat the market, our responsibility at GPIF is to make capital markets more sustainable.

*Hiro Mizuno, CIO, GPIF*



Fiduciary duty implies that asset managers should integrate ESG factors based on beneficiaries interests.

Asset managers should not only meet regulatory requirements, but also integrate ESG factors into investment processes to optimize portfolio structure, mitigate risks and identify companies that meet the trend of economic transformation and have growth potential which give good returns.

*Hong Lei, Chairman of AMAC*

A failure to take into account risks associated with [ESG] factors such as climate change, which may be relevant to the likely long-term performance of a specific investment, or the fund's investments as a whole, is likely to amount to a breach of the duty of care and diligence. Board members must therefore take all reasonable steps to acquire the information in relation to the risks associated with climate change as they may require, in order to make informed decisions when taking such risks into account when exercising the fund's investment powers.

*Fasken, 2019 Pension Fund legal opinion commissioned by Just Share and ClientEarth*



Incorporating financially material ESG factors into investment decision making is integral to investors' fiduciary duty. It underpins the delivery of best possible investment outcomes to beneficiaries because we know that ESG issues are fundamental to a company's long-term performance.

*AustralianSuper*

# AUSTRALIA



<b>Australia in 2018<sup>29</sup></b>	<b>Population:</b> 24.99 million
<b>GDP:</b> 1.432 trillion USD	<b>Over 65 years:</b> 15.74%
<b>Per capita GDP:</b> 57,305 USD	<b>GINI coefficient:</b> 0.33
<b>Market cap:</b> 1.263 trillion USD	<b>CO<sub>2</sub> emissions:</b> 392 Mt
<b>PRI signatories:</b> 148 (37 asset owners)	<b>CO<sub>2</sub> emissions per capita:</b> 16 t

“Incorporating financially material ESG factors into investment decision making is integral to investors’ fiduciary duty. It underpins the delivery of best possible investment outcomes to beneficiaries because we know that ESG issues are fundamental to a company’s long-term performance”.

*AustralianSuper*

## Policy context

Australia has the highest CO<sub>2</sub> emissions per capita among OECD countries. Although the country has ratified the Paris Agreement and the Sustainable Development Goals, there has been little progress on either long-term targets or level of emissions.

In 2018 a group of major Australian financial institutions launched the Australia Sustainable Finance Initiative<sup>30</sup>, which aims to launch by 2020 a Sustainable Finance Roadmap including the following objectives:

- Mobilising capital to deliver on our national and global sustainable development goals commensurable with science-based targets and informed by international conventions, treaties and norms.
- Enhancing the sustainability, resilience and stability of the financial system by embedding sustainability and human rights considerations into financial markets, products and services to better account for and manage risk and impact.
- Ensuring better informed financial decision making by enhancing disclosures and transparency in financial markets for enhanced valuation of environmental and social risks and opportunities.
- Delivering a financial system that meets community and consumer expectations around sustainability and norms including informed engagement, improved and informed choice, effective disclosures and client interests while enhancing financial inclusion and financial well-being.

## The Fiduciary Duty roadmap for Australia<sup>31</sup>

Australia’s pension market has one of the highest growth rates of pension fund assets in the world. Despite this growth, the legal framework for investment decision making in Australia has not changed substantially in recent years. The Australia roadmap makes recommendations for regulatory updates in four categories: regulatory action, stewardship and intermediation, corporate reporting and investor education.

<sup>29</sup> OECD 2018 income inequality data (<https://data.oecd.org/inequality/income-inequality.htm>), IEA 2016 CO<sub>2</sub> emissions data (<https://www.iea.org>) and World Bank 2018 country statistics (<https://data.worldbank.org/>)

<sup>30</sup> <https://www.sustainablefinance.org.au/>

<sup>31</sup> Available at: <https://www.unpri.org/fiduciary-duty/fiduciary-duty-in-the-21st-century-australia-roadmap/258.article>.

## Priority recommendations and regulatory developments

Roadmap recommendation	Progress made and next steps
<p><b>Regulatory action</b></p> <p>The Australian Prudential Regulation Authority (APRA) should update paragraphs 34 and 36 of Prudential Practice Guide SPG 530 Investment Governance (and equivalent prudential standards/guidance applicable to its regulated banks and insurers) to clarify to superannuation funds that ESG issues are material to risk and return analysis. They therefore should be incorporated alongside other risk and return factors in investment decision making.</p>	<p>APRA carried out a review of its prudential framework in 2018 and concluded in its response that SPG 530 Investment Governance and the consideration of ESG factors in formulating investment strategy in particular was one of the potential areas for future enhancement. Further consultation by APRA on any proposed changes is expected to occur by the end of 2019.</p>
<p><b>Stewardship and intermediation</b></p> <p>a) The FSC should continue to work with Australian asset managers to strengthen stewardship expectations, including engaging companies on ESG issues.</p> <p>b) Stewardship expectations could be formalised through the development of a stewardship code. This should be industry-led.</p> <p>c) Australian asset owners should incorporate stewardship expectations in the selection, appointment and monitoring of asset managers.</p>	<p>In July 2017, the FSC developed FSC Standard 23 to replace its ‘blue book’ for its members. Key elements of the standard include asset managers providing (i) a description of their approach to asset stewardship (ii) how this is exercised effectively on behalf of their clients. Asset managers, (iii) a description of their approach to monitoring and engaging with investee companies and (iv) the connection between monitoring, engagement, proxy voting and investment decision.</p> <p>In May 2018, ACSI released the first Australian stewardship code for asset owners. The voluntary code is opened to all asset owners, including non ACSI members.</p> <p>The awareness of stewardship and its benefits to the Australian financial system is low amongst AOs.</p> <p>There needs to more awareness and knowledge building amongst AOs on stewardship practices and the role and responsibilities AOs have in setting the tone on stewardship. This will help to improve on the quality of stewardship practices and the influence AOs should exert on investment managers</p> <p>There should be a coordinated discussion from various stakeholders on an appropriate Stewardship Code, using ACSI’s code as a starting point</p> <p>There should be a minimum set of reporting standards on stewardship activities that is applicable to all investors</p>
<p><b>Corporate reporting</b></p> <p>The Australian Securities Exchange (ASX) should continue to enhance corporate reporting and disclosure requirements and guidance. The Australian Securities and Investments Commission (ASIC) should monitor the quality of corporate reporting and disclosure.</p>	<p>ASX is now a member of the SSE and is in the process of signing to the TCFD. In its 4th edition of its Corporate Governance Guidelines released in 2019, there have been several measures to encourage improvements on the disclosure of ESG risks.</p> <p>ASX has maintained the same ‘if not, why not’ approach to disclosure. Whilst there has been no change to Principle 7, Principle 3 has been significantly redrafted to place a stronger emphasis on culture and values.</p> <p>ASX should introduce mandatory disclosure on ESG factors that are financially material</p> <p>ASX and ASIC should agree on a standardised set of primary ESG disclosure indicators that companies should be required to report on</p>
<p><b>Investor education</b></p> <p>Trustee boards should ensure capacity and competence on ESG issues. This should be industry-led.</p>	<p>In May 2019, ACSI published its policy update on stewardship. The PRI launched the RI Review Toolkit and RI for Trustees on PRI Academy.</p> <p>Following the climate change litigation case on Rest, one of the largest superannuation funds in Australia, Trustee board awareness on ESG issues, particularly climate risks have increased. This litigation reinforces one of the key findings of the legal opinion that was released by the Centre for Policy Development (CPD) in Oct 2016; directors who fail to consider the impact of foreseeable climate change risks on their business property could be held personally for breaching the duty of due care and diligence they owe to their companies. While majority of the investment consultants are aware of ESG risks, they have failed to recognise the importance of climate risk and as a result of this, investment consultants have not been strong supporters of climate risk. The litigation has forced the consultants to acknowledge their oversight and climate risk and many are in the process of developing and/or improving their internal ESG capabilities.</p> <p>The legal community, investors associations like CPF and investment consultants are recognising the importance for superannuation trustee boards and company directors to have competence in ESG issues and can demonstrate how these ESG risks are managed in their portfolios.</p> <p>Trustee boards need to ensure there is a clear RI philosophy and RI objectives that is both reflective and supportive of the investment beliefs and investment objective.</p> <p>Trustee boards need to demand more and challenge its investment committee to demonstrate the consideration of climate risks and ESG risks in the investment process.</p> <p>We are supportive of ACSI’s recommendation that APRA needs to revise its standards and guidance to explicitly recognise the importance of ESG issues in the formulation of investment strategies and in the investment decision making process. Superannuation trustee boards need to have access to capacity and competence on ESG issues as Trustee board education is imperative.</p>

# BRAZIL



<b>Brazil in 2018</b>	<b>Population:</b> 209.47 million
<b>GDP:</b> 1.869 trillion USD	<b>Over 65 years:</b> 8.87%
<b>Per capita GDP:</b> 8,921 USD	<b>GINI coefficient:</b> N/A
<b>Market cap:</b> 916.82 billion USD	<b>CO<sub>2</sub> emissions:</b> 417 Mt
<b>PRI signatories:</b> 48 (13 asset owners)	<b>CO<sub>2</sub> emissions per capita:</b> 2 t

Previc<sup>32</sup> has incorporated the need for pension funds to consider environmental, social and governance aspects in their investment risk analysis into current regulations, whenever possible, as well as the need to comply with these guidelines in the investment policy.

*Resolution CMN n. 4661 and Instruction Previc n.6*

## Policy context

Brazil is the eighth largest economy and the most biodiverse country in the world. It has maintained its relative economic leadership in Latin America, despite the crisis that has slowed its economy since 2014. Continuous fiscal deficits have prevented the country from returning to the growth track. Nonetheless, some structural measures have been implemented, such as the public pension system reform, which has improved expectations of economic growth.

Some of the new government’s main objectives:

- Decrease the burden of public spending through privatisation, the review of some welfare programs and the implementation of structural changes such as the public pension system reform.
- Improve the business environment by reducing bureaucracy, simplifying the tax system and reviewing some labour rights.

- Review the roles of the Brazilian National Development Bank, ceasing subsidised credit operations to key sectors and fostering the credit lines of private banks.

In the last decade Brazil has modernised its financial market regulatory framework to include ESG requirements:

- Since 2014, the Brazilian Central Bank has required that banking institutions establish and implement responsible investment policies.
- In 2015, CVM, the Brazilian securities exchange commission, adopted a governance code regarding the issuance of listed securities with a “comply or explain” approach, which includes ESG issues.
- Since 2018, Previc, the pension funds supervisor, has required the disclosure of ESG risks in pension funds’ investment policies and analysis.

The private sector has also helped the country foster a sustainable investment agenda. Some key developments include:

- B3, the Brazilian stock exchange, was the first to adhere to the UN Global Compact, in 2004. B3 also is a founding signatory of the UN Sustainable Stock Exchanges (SSE).
- In 2016, AMEC, the Association of Capital Market Investors, launched its stewardship code. The code states that investors shall “take ESG factors into account in their investment processes and stewardship activities”.
- In April 2019, Abrapp, the pension funds association, launched their Self-regulation Code of Corporate Governance, which requires that “pension funds always consider the balance between social and environmental responsibility and the return on investments”.

32 National Superintendence for Pension Funds in Brazil.

## The Fiduciary Duty roadmap for Brazil<sup>33</sup>

After a decade of economic and social prosperity from 2004 to 2014, Brazil faced a series of political crises, like the impeachment of the president Dilma Rousseff, in 2016. Following official investigations into a major of corruption scandal (known as operation ‘Java Lato’) the financial market regulator and supervisors have established stricter rules to prevent conflicts of interest and mitigate risks of unethical behaviour. The Brazil roadmap was established on the back of this context which significantly elevated the level of investor focus on corporate governance and stewardship. The roadmap sets out recommendations in five categories: regulatory action, investor education, corporate reporting, stewardship and engagement and industry guidance.

At the time of writing, the Amazon rainforest, the largest in the world, is at serious threat from forest fires. In September 2019, 230 institutional investors, representing more than USD 16 trillion in assets under management, called for corporate action on deforestation: “As investors, who have a fiduciary duty to act in the best long-term interests of our beneficiaries, we recognise the crucial role that tropical forests play in tackling climate change, protecting biodiversity and ensuring ecosystem services”.<sup>34</sup>

## Priority recommendations and regulatory developments


Roadmap recommendation	Progress made and next steps
<p><b>Regulatory action</b></p> <p>a) The Superintendence of Private Pension Funds (PREVIC) should recommend a revision to Resolution 3.792 which governs investment practices and disclosures by closed pension schemes.</p> <p>b) Oversight and monitoring by the Central Bank of Brazil (the Central Bank) of the impact of Resolution 4.327 on the investment activities of relevant regulated entities.</p>	<p>a) In May 2018, the National Monetary Council launched Resolution 4661, which requires that, in their risk analysis, pension funds consider their investments’ economic sustainability together with their environmental, social and environmental risks, whenever possible. In November 2019, Previc reinforced this requirement by introducing Instruction 6, which requires that pension funds consider ESG risks in their investment policy.</p> <p>b) The Resolution 4557/2017 included environmental and social risks in the roll of risks that banking institutions shall identify and mitigate. In addition, the Central Bank’s audit department has adopted some criteria to measure the level of exposure to ESG risks, which has guided supervisory activities. These criteria are focused on economic activities with a high potential for environmental damage.</p> <p>The National Monetary Council should align the ESG requirements in all regulated markets, extending the regulatory modernisation to the insurance market supervised by SUSEP.</p>
<p><b>Investor education</b></p> <p>Industry associations and accreditation agencies are to collaborate on raising ESG awareness and the provision of practical training.</p>	<p>Some initiatives dedicated to improving the knowledge on ESG integration in the financial community have emerged. As an example, in March 2019 the British Council in Brazil sponsored a series of workshops on ESG integration targeted towards pension fund investment managers and Previc’s auditors.</p> <p>Abrapp, the pension funds association, should support a comprehensive plan to build capacity on ESG issues among its members.</p>
<p><b>Corporate reporting</b></p> <p>The securities regulator (CVM) should review the effectiveness of reporting of material ESG factors by Brazilian corporations.</p>	<p>CVM co-leads the Financial Innovation Lab,<sup>35</sup> the most important initiative for sustainable and innovative finance in Brazil, together with GIZ, the Brazilian Association for Development (ABDE) and the Interamerican Development Bank (IDB). Although disclosure is an issue that has been discussed in all the Lab’s working groups, the Lab has just created the Working Group on ESG Risk Management and Transparency, whose main objective is to improve the effectiveness of ESG reporting and disclosure in Brazil.</p>
<p><b>Stewardship and engagement</b></p> <p>CVM should adopt the Brazilian Association of Capital Market Investors’ (AMEC) stewardship code.</p>	<p>The stewardship code adoption in Brazil is still in its early stages. CVM has supported the market uptake of the code’s principles. However, the supervisor recommends that the code should remain a self-regulatory initiative whilst the market matures.</p>
<p><b>Guidance</b></p> <p>Regulatory and industry associations are to provide guidance for asset managers and private pension providers on the scope and content of their fiduciary duties.</p>	<p>The market still lacks a glossary of terms, which is one of the deliverables of the Lab’s Working Group on ESG Risk Management and Transparency. Therefore, the working group could leverage this experience to develop a guide on ESG integration and reinforce the importance of the analysis of ESG factors as part of asset managers’ fiduciary duties.</p> <p>The ESG working group of the Finance Innovation Lab should include the elaboration of a guide on ESG Integration for the scope of its activities.</p>

<sup>33</sup> Available at: <https://www.unpri.org/fiduciary-duty/fiduciary-duty-in-the-21st-century-brazil-roadmap/259.article>.

<sup>34</sup> Available at: <https://www.unpri.org/news-and-press/230-investors-with-usd-162-trillion-in-aum-call-for-corporate-action-on-deforestation-signaling-support-for-the-amazon/4867.article>.

<sup>35</sup> Available at: <http://www.labinovacaofinanceira.com/>.

# CANADA

	<b>Canada in 2018</b>	<b>Population:</b> 37.06 million
	<b>GDP:</b> 1.71 trillion USD	<b>Over 65 years:</b> 17.4%
	<b>Per capita GDP:</b> 46,125 USD	<b>GINI coefficient:</b> 0.31
	<b>Market cap:</b> 1.94 trillion USD	<b>CO<sub>2</sub> emissions:</b> 541 Mt
	<b>PRI signatories:</b> 133 (43 asset owners)	<b>CO<sub>2</sub> emissions per capita:</b> 14.9 t

“For Canada to be competitive in a world that is increasingly concerned about sound environmental stewardship, sustainable finance needs to become business as usual in the Canadian financial services industry”.

*Tiff Macklem, Chair of the Expert Panel on Sustainable Finance*

## Policy context

Canada has yet to formally establish goals directly linked to sustainable finance but has the following official initiatives in place:

- The Federal Sustainable Development Strategy outlining 13 goals linked to environmentally sustainability priorities, which is updated every three years.
- The Pan-Canadian Framework on Clean Growth and Climate Change, a plan developed by provinces and territories (in consultation with indigenous peoples) to meet emissions reduction targets and build resilience to climate change.

In April 2018, the federal government of Canada (Ministers of Environment and Climate Change, and Finance) appointed the Expert Panel on Sustainable Finance to undertake consultation with leaders of the finance community and make recommendations to align Canada’s financial system with a sustainable future.

In October 2018, the Expert Panel released its interim report outlining the opportunities and challenges related to sustainable finance and climate related risk disclosures as well as interim recommendations for the Federal government to consider.

The final report was released in June 2019 and included 15 recommendations that were grouped into three pillars: opportunity, foundations for market scale and financial products and markets for sustainable growth.

### Pillar I: Opportunity

1. Map Canada’s long-term path to a low-emissions, climate-smart economy, sector by sector, with an associated capital plan.
2. Provide Canadians the opportunity and incentive to connect their savings to climate objectives.
3. Establish a standing Canadian Sustainable Finance Action Council (SFAC), with a cross-departmental secretariat, to advise and assist the federal government in implementing the Panel’s recommendations.

### Pillar II: Foundations for Market Scale

4. Establish the Canadian Centre for Climate Information and Analytics (C3IA) as an authoritative source of climate information and decision analysis.
5. Define and pursue a Canadian approach to implementing the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD).
6. Clarify the scope of fiduciary duty in the context of climate change.
7. Promote a knowledgeable financial support ecosystem.
8. Embed climate-related risk into monitoring, regulation and supervision of Canada’s financial system.

### Pillar III: Financial Products and Markets for Sustainable Growth

9. Expand Canada’s green fixed income market and set a global standard for transition-oriented financing.
10. Promote sustainable investment as ‘business as usual’ within Canada’s asset management community.
11. Define Canada’s clean technology market advantage and financing strategy.
12. Support Canada’s oil and natural gas industry in building a low-emissions, globally competitive future.

- 13. Accelerate the development of a vibrant private building retrofit market.
- 14. Align Canada’s infrastructure strategy with its long-term sustainable growth objectives and leverage private capital in its delivery.
- 15. Engage institutional investors in the financing of Canada’s electricity grid of the future.

### The Fiduciary Duty roadmap for Canada<sup>36</sup>

The Canada roadmap sets out recommendations in four categories: regulatory action, stewardship, corporate reporting and investor education.

Canada has, in many ways, a supportive environment for the consideration of ESG issues. For example, the Canadian supreme court has held that directors of Canadian corporations considering action in the best interests of the corporation may take into account the interests of shareholders, employees, creditors, customers, governments and the environment.

The understanding and assumptions of many Canadian corporate boards and pension fiduciaries may “lag the trajectory of the law” and best practice, knowledge and awareness of ESG issues. This is a problem common to other mature markets. As such, trustees of Canadian pension schemes should be trained on ESG issues (such as those carried out by organisations like the International Centre for Pension Management at Rotman Business School and SHARE).


In this context, regulators should broaden their methods to protect investors. This would acknowledge that ESG factors are a key element in investor protection, in addition to the welcome development of policy in relation to avoiding conflicts of interest and poor charging structures.

### Priority recommendations and regulatory developments

Roadmap recommendation	Progress made and next steps
<p><b>Regulatory action</b></p> <p>Canadian pensions regulators should require pension plans to disclose ESG integration practices.</p> <p>Canadian securities regulators should adopt mandatory “say on pay” votes at Canadian public companies.</p>	<p>Provincial pension regulators have not moved on legislation since FSCO (Ontario regulator) implemented mandatory disclosure in 2015, although there has been some interest in British Columbia and Alberta. Ontario remains company or explain.</p> <p>Recommendation 6.1 of the Expert Panel recommends the Minister of Finance issue a public statement articulating that the consideration of climate factors is firmly within the remit of fiduciary duty. Recommendation 6.3 recommends climate-related disclosure legislation for federally-regulated pension plans and encourage provincial regulators to consider similar requirements.</p> <p>An amendment to the Canada Business Corporations Act (CBCA) was proposed in April 2019 that would require corporations incorporated under CBCA to provide an annual Say on Pay vote.</p>
<p><b>Stewardship</b></p> <p>Asset owners should advance trends and best practice in shareholder engagement.</p>	<p>There is no stewardship code in Canada. There have been efforts from industry groups, for example, Canadian Coalition for Good Governance, to advance stewardship. Recommendation 6.4 of the Expert Panel recommends the development of a stewardship code.</p>
<p><b>Corporate reporting</b></p> <p>The CSA should conduct a comprehensive review of the reporting of material ESG factors, following which it should expand its reporting framework and guidance.</p>	<p>The Canadian Securities Administrator has released a notice with guidance for public companies on reporting material climate change risks. The notice is focused on disclosure obligations for management discussion and analysis (MD&amp;A) documents and annual information forms (AIF).</p> <p>TSX joined the Sustainable Stock Exchanges Initiative in 2018 but has not yet mandated listing requirements on the basis of ESG reporting. They do have written guidance on ESG reporting (most recent published in 2014).</p>

<sup>36</sup> Available at: <https://www.unpri.org/fiduciary-duty/fiduciary-duty-in-the-21st-century-canada-roadmap/260.article>.

# CHINA

	<b>China in 2018</b>	<b>Population:</b> 1.393 billion
	<b>GDP:</b> 13.608 trillion USD	<b>Over 65 years:</b> 11.2%
	<b>Per capita GDP:</b> 9,771 USD	<b>GINI coefficient:</b> 0.46
	<b>Market cap:</b> 6.23 trillion USD	<b>CO<sub>2</sub> emissions:</b> 9,057 Mt
	<b>PRI signatories:</b> 31 (1 asset owner)	<b>CO<sub>2</sub> emissions per capita:</b> 6.6 t

“Fiduciary duty implies that asset managers should integrate ESG factors based on beneficiaries interests. Asset managers should not only meet regulatory requirements, but also integrate ESG factors into investment processes to optimize portfolio structure, mitigate risks and identify companies that meet the trend of economic transformation and have growth potential which give good returns.”

*Hong Lei, Chairman of AMAC*

## Policy context

China is the world's second largest economy and one of the world's most polluting economies. Historically, economic growth and environmental sustainability were inversely related. This is changing, however. For China today, the guiding principle of sustainability is to simultaneously pursue economic growth, social development and environmental protection, both domestically and internationally.

China has set ambitious goals that provide a supportive environment for the development of sustainable investment regulations. The key economic goals of the government are as follows:

- High-quality economic development through finance, including the following actions:
  - Providing stronger support for the real economy.
  - Further opening up of the financial industry, with foreign financial institutions allowed to set up or hold shares of pension fund management companies in China.<sup>37</sup>
- Sound development of the capital market, including:
  - Reform of stock listing and delisting.
  - Improving the quality of listed companies through better corporate governance and enhanced information disclosure.
  - Encouraging more institutional investors.
- Eradicating poverty, with a focus on poverty alleviation in rural areas by 2020.
- Pollution control (air pollution especially) and resource conservation through industrial structure optimisation by 2020.

Since 2016, China has developed a high-level policy framework on green finance, and Chinese regulators have since been working on implementing this policy in terms of detailed guidance and regulations:

- 2016: **Guidelines for Establishing a Green Financial System (GEGFS)** – This high-level policy framework was adopted by seven government agencies and ministries; it includes measures to develop the green bond market and to promote green and sustainable investment in the securities market.
- 2017: **Government goal of ‘creating an ecological civilisation’ and ‘Beautiful China’** – Promoting resource conservation and environmental protection through green and sustainable finance.

<sup>37</sup> State Council, July 2019.



- **Green Investment Guidelines by AMAC** (the Asset Management Association of China) – A voluntary implementation guidance to encourage fund managers to consider environmental sustainability in their portfolio and raise awareness of ESG risks.
- **NDRC (National Development and Reform Commission) guidance on green industry** – A catalogue to clarify the standards of green industry and green projects.

### The Fiduciary Duty roadmap for China: Investor Duties and ESG Integration<sup>38</sup>

Fiduciary duty per se is not a well-established concept in Chinese law. However, many of the principles that underpin fiduciary duties – for example, duties of loyalty and prudence; requirements to act with care, skill and diligence; and requirements to act in good faith in the interest of beneficiaries and clients – are familiar to Chinese investors. These duties are not defined in a single body of law but have emerged from the complex interaction of regulation, soft law and market innovation. Together, they create a set of investor duties and obligations that mirror those expected of investors in other jurisdictions.

Investor duties in China do not explicitly require investors to integrate the consideration of material ESG issues into their investment decision making, nor do they require investors to consider the Chinese government’s long-term sustainability goal, articulated in the concept of the Ecological Civilisation. However, there is a strong investment case for doing so, while such a consideration is in line with the interests of clients and beneficiaries.

The central recommendation of our roadmap is that investors should integrate ESG issues into their investment decision-making processes as part of fulfilling their duties towards their beneficiaries and to support the development of China’s Ecological Civilisation. Investor duties should reflect and align with the Chinese government’s Guidelines for Establishing a Green Financial System.

### Priority recommendations and regulatory developments

Roadmap recommendation	Progress made and next steps
<p><b>Sustainable investment guidance</b></p> <p>Publishing guidance on green and sustainable investment that articulates how institutional investors and their investment managers should implement the Guidelines for Establishing a Green Financial System.</p>	<p>In 2018, AMAC published the Green Investment Guidelines. These guidelines promote ESG integration, long-term investing and company engagement.</p> <p>While voluntary, and focused on green investment, these guidelines are the first regulatory tool directed at investors, issued from the overarching GEGFS. They connect high-level policy with investment decision making. The guidelines constitute a signal to investors as to normative expectations regarding their contribution to the government’s goal of creating an ecological civilisation.</p> <p>We recommend that AMAC continues clarifying the role of ESG integration and disclosure in fulfilling the goal of the GEGFS.</p>
<p><b>Regulatory action</b></p> <p>Introducing regulation for pension funds to integrate ESG issues, encourage high standards in investee companies and disclose ESG practices and performance.</p>	<p>In 2018, pension funds were authorised to invest in foreign equity through mutual recognition funds.</p> <p>In 2019, the CSRC is expected to publish measures to promote the two-way opening of China’s investment market to further facilitate overseas investment. CSRC is expected to fully remove the limit on foreign equity ratios in the securities and futures industries by 2021.</p> <p>There aren’t any requirements for pension funds and asset owners to integrate ESG.</p> <p>In order to fulfil the goal of high-quality economic development, and at the same time reduce pollution and poverty, asset owners should be encouraged to systematically integrate ESG issues into their investment decision making. By doing so, they will lead other investors and asset managers by example, mainstreaming sustainable investment and driving green and sustainable economic growth.</p>
<p><b>Corporate reporting</b></p> <p>Ensuring and monitoring the effectiveness of the mandatory environmental disclosure framework for companies and aligning with international disclosure standards for ESG issues.</p>	<p>In 2020, CSRC plans to issue a mandatory environmental disclosure framework for listed companies.</p> <p>CSRC should clarify that ESG factors are financially material. In order to provide usable and comparable ESG data to investors, companies should be required to report on a standardised set of primary ESG disclosure indicators.</p>
<p><b>Investor education</b></p> <p>Supporting investor education and ESG investment research. Building operational capacity for sustainable investment.</p>	<p>AMAC has published dedicated research on the topic of ESG integration.</p> <p>AMAC, with support from investment managers and service providers, should further promote the integration of ESG topics in investor education and investment research.</p>

<sup>38</sup> Available at: <https://www.unpri.org/fiduciary-duty/investor-duties-and-esg-integration-in-china/2915.article>.

# EUROPEAN UNION



<b>EU in 2018</b>	<b>Population:</b> 513.21 million
<b>GDP:</b> 18.75 trillion USD	<b>Over 65 years:</b> 19.93 %
<b>Per capita GDP:</b> 36546.40 USD	<b>GINI coefficient:</b> -
<b>Market cap:</b> -	<b>CO2 emissions:</b> 3241.84 Mt (2014)
<b>PRI signatories:</b> 1197 ( 228 AOs)	<b>CO2 emissions per capita:</b> 6.38 t (2014)

“We do not need economic growth for the sake of growth but for the sake of well-being of people. This means taking social and environmental factors into account”.

*Valdis Dombrovskis, EU Commissioner*

## Developments around investor and fiduciary duties

The 2015 report *Fiduciary Duty in the 21st Century* recognised the significance of the EU as a centre for financial regulation. Although the term “fiduciary duty” is not embedded in EU law, the concepts of prudence and loyalty are part of the foundation of existing EU finance policy.

The report recommended that the EU provide guidance to Member States on the interpretation of fiduciary duty in the national legal context and encourage harmonised and consistent legislation across the EU. It also recommended that Member States monitor the implementation of legislation and other policy measures relating to fiduciary duty and report on the investment, and any additional, outcomes that result.

In 2016, European policy makers reached agreement on a revised *Institutions for Occupational Retirement Provision (IORP) Directive* which for the first time mandated the consideration of ESG issues by regulated pension funds. Agreement was also reached on a

revised *Shareholder Rights Directive* which sought to strengthen stewardship and address short-termism and principal-agent problems in the investment chain.

In January 2016, the EU launched a call for evidence on long-term, sustainable investment. The PRI’s response indicated that, while these developments were welcome, they lacked a clear strategy or vision for the EU.

In 2017, the EU established a High-Level Expert Group on Sustainable Finance, tasked with proposing such a vision. One of the group’s key recommendations was that the EU clarify investor duties through an “omnibus” directive. The EU responded to the HLEG by establishing sustainability at the heart of the Capital Markets Union programme and setting up a dedicated Action Plan on Financing Sustainable Growth.

The action plan outlines ten reforms in three areas:

- Reorient capital flows towards sustainable investment, in order to achieve sustainable and inclusive growth:
  - Establish an EU classification system for sustainability activities.
  - Create standards and labels for green financial products.
  - Foster investment in sustainable projects.
  - Incorporate sustainability when providing investment advice.
  - Develop sustainability benchmarks.

“ESG is part of our core mandate. We want to ensure a successful securities market to support sustainable growth in Europe”.

*Roxana De Carvalho, Head of the Corporate Affairs Department, European Securities and Markets Authority (ESMA)*

- Mainstream sustainability into risk management:
  - Better integrate sustainability into ratings and research.
  - Clarify institutional investors’ and asset managers’ duties.
  - Incorporate sustainability into prudential requirements.
- Foster transparency and long-termism in financial and economic activity:
  - Strengthen sustainability disclosure and accounting rule making.
  - Foster sustainable corporate governance and attenuate short-termism in capital markets.

The first legislative proposals from the Action Plan achieved political agreement in 2019. Of particular relevance, the ‘Regulation on sustainability-related disclosures for the financial services sector’ was adopted in March 2019. This regulation lays down transparency rules on the integration of sustainability risks and the consideration of adverse sustainability impacts in investors’ and financial advisors’ processes, and on the provision of sustainability-related information on financial products.


The regulation will also encourage investors to understand and mitigate the potential adverse impacts of their investment on society and the environment. This is consistent with the direction of the broader sustainable finance agenda, as investors increasingly work to understand non-financial investment outcomes.

The European Commission, building on technical advice from the European Supervisory Authorities (ESAs), has been drafting amendments to delegated acts under the UCITS Directive, Solvency II, AIFM Directive, MiFID II and the Insurance Distribution Directive, to clarify that sustainability must be considered in all interpretations of the prudent person principle, governance and risk management.

“Any discussion about fiduciary duty and pension funds must recognise that pension funds need to think about the future. We are currently conducting quantitative and qualitative assessments of how pensions funds are prepared for a 2 degrees scenario”.

*Manuela Zweimueller, Head of Policy Department, European Insurance and Occupational Pensions Authority (EIOPA)*

# FRANCE

	<b>France in 2018</b>	<b>Population:</b> 66.99 million
	<b>GDP:</b> 2.78 trillion USD	<b>Over 65 years:</b> 20.1%
	<b>Per capita GDP:</b> 41464 USD	<b>GINI coefficient:</b> 0.29
	<b>Market cap:</b> 2.37 trillion USD	<b>CO<sub>2</sub> emissions:</b> 293 Mt
	<b>PRI signatories:</b> 217 (22 asset owners)	<b>CO<sub>2</sub> emissions per capita:</b> 4.4 t

“The Paris Agreement on climate change is not just an environmental treaty but offers the basis for a new and inclusive model of development. France is committed to making finance a driving force behind this transition”.

*Brune Poirson, Secretary of State, Ministry for the Ecological and Inclusive Transition, France*

## Policy context

France has been a champion of climate action internationally. In 2002, as the US refused to sign the Kyoto Protocol, Jacques Chirac, then President of the French Republic, called for action by all countries, saying “Our house is burning, and we look elsewhere”. This commitment was epitomised in 2015 with the organisation of COP 21 and the subsequent adoption of the Paris Agreement. France has continued to act as a coordinator of international climate action, organising the inaugural One Planet Summit as the US announced their withdrawal from the agreement to rally supportive forces.

France reduced its GHG emissions by 16% between 1990 and 2016.<sup>39</sup> France also has the lowest level of emissions per capita in the G7, with 4.4t CO<sub>2</sub>/cap, and well below the G7 average of 10.8 tCO<sub>2</sub>/cap.<sup>40</sup>

<sup>39</sup> Available at: <https://www.lesechos.fr/industrie-services/energie-environnement/la-france-a-reduit-ses-emissions-de-gaz-a-effet-de-serre-en-2018-1030621>.

<sup>40</sup> Source: [www.iea.org](http://www.iea.org)

Supportive policies, such as the ones listed below, set out trajectories to reduce GHG emissions and align the financial sector with those objectives:

- **Loi relative a la Transition Energétique pour la Croissance Verte, or Energy Transition law (August 2015)<sup>41</sup>** – This is a set of policies to provide a common framework for climate action in France. It sets long-term goals to reduce GHG emissions and energy consumption, improve buildings' energy efficiency and increase renewable energies. It also provides tools to track sectoral and regional contributions to the low carbon transition.
- **Loi Energie et Climat (debated in Parliament as of September 2019)<sup>42</sup>** – Adopt a new set of long-term goals to achieve carbon neutrality by 2050.

The French government has also been developing strategies to achieve more sustainable growth. It includes the protection of France's biodiversity,<sup>43</sup> the development of a circular economy<sup>44</sup> and the expansion of the Social Solidarity Economy Sector.<sup>45</sup> To support those transitions, the French government created an EUR 57 billion investment plan<sup>46</sup> to unlock investment opportunities that accelerate the low carbon transition, reinforce the attractiveness of France's workforce, strengthen innovation and develop digital services.

Since 2001, France has developed a policy framework on sustainable finance, focusing on developing the demand for sustainable investments, building on the initial involvement of government-affiliated institutional investors (Caisse des Dépôts et Consignations, FRR, Ircantec and ERAFP) and ensuring the reliability of sustainable investment offers.

- **2001: Article 21 of the Loi sur la généralisation de l'épargne salariale** requires managers of occupational pension schemes, when asked, to disclose how environmental and social issues might have affected their decision making. The Loi sur les Nouvelles Régulations Economiques requires the disclosure of environmental and social data by French companies.

- **2010: Article 225 of the Loi Grenelle II** requires corporate entities, including investment managers, to disclose audited information on the environmental and social impact of their business activities and on their CSR strategy.
- **2015: Article 173 of the Loi relative a la Transition Energétique pour la croissance verte** requires French institutional investors and investment managers to disclose information on the integration of climate and ESG risks into their decision making.
- **2016: Establishment of two government-led labelling schemes, Greenfin and ISR**, for sustainable financial products.
- **2017: Loi relative au devoir de vigilance (Duty of Care)** requires large French companies to establish and disclose due diligence policies for environmental and social risks in their supply chain.
- **2018: Roadmap for sustainable finance of the French Securities Market Authority (AMF)**, which sets the priorities for the supervision of the responsible investment market in France.
- **2019: Loi Plan d'Action pour la Croissance et la Transformation des Entreprises**, which includes several provisions to clarify directors' duties, introduce new product-level ESG requirements for employee saving schemes and transpose the Shareholder Rights Directive.
- **Loi Energie et Climat** updates the 2015 Energy Transition law, including Article 173.

41 Available at: <https://www.ecologique-solidaire.gouv.fr/loi-transition-energetique-croissance-verte>.

42 Available at: <https://www.ecologique-solidaire.gouv.fr/adoption-du-projet-loi-energie-climat-vers-neutralite-carbone-en-2050>.

43 Loi pour la reconquête de la biodiversité, de la nature et des paysages, available at: <https://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000033016237&categorieLien=id>.

44 Feuille de route de l'économie circulaire, available at: <https://www.ecologique-solidaire.gouv.fr/feuille-route-economie-circulaire-frec>, et Projet de loi anti-gaspillage pour une économie circulaire, available at: <https://www.ecologique-solidaire.gouv.fr/loi-anti-gaspillage>.

45 Loi Economie sociale et solidaire, available at: <https://www.economie.gouv.fr/ess-economie-sociale-solidaire/loi-economie-sociale-et-solidaire>.

46 Le Grand plan d'investissement 2018-2022, available at: <https://www.gouvernement.fr/action/le-grand-plan-d-investissement-2018-2022>.

## The Fiduciary Duty roadmap for France<sup>47</sup>

Fiduciary duty per se is not a well-established concept in French law. However, many of the principles that underpin fiduciary duties – for example, the duties of loyalty and prudence, and requirements to act with care – are familiar to French investors. Therefore, the shift towards ESG integration came about through dedicated disclosure requirements, and the clarification of investor duties would require amending the existing legal framework to improve ESG integration practices and extend investors’ ESG disclosure requirements.

The roadmap makes recommendations to strengthen France’s role in the development of responsible investment, capitalising on progress. In addition to the clarification of investors’ duties, it suggests the (i) encouragement of analysis and measurement of the impacts of investment activities, (ii) creation of an environment in which responsible investment can flourish, and (iii) strengthened collaboration between public and private actors.

## Priority recommendations and regulatory developments

Roadmap recommendation	Progress made and next steps
<p><b>Regulatory action</b></p> <p>The French government should revisit the existing regulatory framework to clarify that all investors (asset owners and investment managers) should integrate ESG issues into their processes and decision making, ending the “comply or explain” approach.</p>	<p>The adoption of the EU Regulation on sustainability-related disclosures in the financial services sector<sup>48</sup> established an EU-wide disclosure framework for investors. Article 173 is being amended to incorporate this within the French regulatory framework. The amendment should ensure that the provisions that are not in the European framework (for instance the alignment with the Paris Agreement) will be safeguarded.</p> <p>The update of Article 173, currently discussed as part of the Energy and Climate bill,<sup>49</sup> extends the scope to investors not covered by the initial version of Article 173 (including the Banque de France, reinsurers and banks that are advising on or managing third parties’ portfolios). It should be supplemented by the amendments to the delegated acts under the UCITS Directive, Solvency II, AIFM Directive, MiFID II and to the Insurance Distribution Directive currently prepared by the European Commission to clarify that sustainability must be considered in the interpretation of the prudent person principle, governance and risk management.</p> <p>Government authorities, in collaboration with industry associations, should create mechanisms to establish minimum standards for ESG integration. It would ensure investors’ comparability and facilitate supervision.</p> <p>Government authorities, in collaboration with industry associations, should create mechanisms to develop shared methodologies to assess the alignment with long-term objectives like the Paris agreement.</p>
<p><b>Measuring impact</b></p> <p>The French government should integrate social and environmental outcomes into financial institutions’ responsibilities.</p>	<p>The Loi PACTE, adopted in 2019,<sup>50</sup> clarified that companies, including most French asset owners such as insurance and mutual insurance companies, should take into account the social and environmental impacts of their activities. It also offers companies the opportunity to enshrine their broader responsibility towards society, or “raison d’être”, in their legal status.</p> <p>While setting a broader definition of companies’, including some investors’, duties to include the environmental and social impacts on their broader stakeholders, the Loi PACTE does not include any provision regarding supervision or transparency on the integration of the environmental and social outcomes by companies.</p> <p>However, the adoption of the ‘Regulation on sustainability-related disclosures for the financial services sector’, which lays down transparency rules on the consideration of adverse sustainability impacts in investors’ and financial advisors’ processes, will further encourage investors to understand and mitigate the potential adverse impacts of their investments on society and the environment.</p>

47 Available at: <https://www.unpri.org/sustainable-markets/fiduciary-duty>.

48 See the PRI’s briefing on the EU Regulation on Sustainability-related disclosures in the financial services sector.


49 Available at: <https://www.ecologique-solidaire.gouv.fr/adoption-du-projet-loi-energie-climat-vers-neutralite-carbone-en-2050>.

50 Available at: <https://www.legifrance.gouv.fr/affichLoiPubliee.do?idDocument=JORFDOLE000037080861&type=general&legislature=15>.

## Priority recommendations and regulatory developments

Roadmap recommendation	Progress made and next steps
<p><b>Enabling environment</b></p> <p>The French government should make sustainable financial products more transparent and systematic.</p>	<p>The Loi PACTE includes a provision to increase the demand for sustainable investments within life insurance. As of 2020, when purchasing a life insurance product, clients should be offered either an SRI-labelled fund, a GreenFin-labelled fund or a social impact fund.</p> <p>Insurers have been the drivers of responsible investment growth in France in recent years. This provision should ensure that they keep driving demand for sustainable investment while ensuring that the end-investors' ESG preferences are met.</p> <p>The government should create similar requirements for employee savings schemes.</p>
<p><b>Stewardship</b></p> <p>The French Markets Securities Authority (AMF) should enhance the efficiency of the dialogue between investors and issuers.</p>	<p>The Loi PACTE includes a provision to transpose the requirements of the Shareholder Rights Directive. French investors are now required to have an engagement policy and to report annually on its implementation.</p> <p>The AMF should provide guidance on the content of the engagement policy, which would explicitly require investors to engage on sustainability-related issues.</p> <p>The AMF should work to improve shareholder democracy in Annual General Meetings, lowering the requirements to file a shareholder resolution and increasing the transparency in the (proxy) voting process.</p>
<p><b>Strengthen collaboration between public and private actors</b></p>	<p>The French regulators, AMF and ACPR, announced that they would reinforce their cooperation to supervise investors' sustainability disclosures and the implementation of investors' commitments on sustainable finance. The regulators will publish an annual report making recommendations to improve practices.</p> <p>The AMF is also setting up a Commission on Sustainable Finance and the Climate. Composed of experts, it should be a collaborative forum for financial market participants.</p>

# GERMANY

	<b>Germany in 2018</b>	<b>Population:</b> 82.93 million
	<b>GDP:</b> 3.997 trillion USD	<b>Over 65 years:</b> 21.66%
	<b>Per capita GDP:</b> 48,196 USD	<b>GINI coefficient:</b> 0.29
	<b>Market cap:</b> 1.75 trillion USD	<b>CO<sub>2</sub> emissions:</b> 732 Mt
	<b>PRI signatories:</b> 95 (21 asset owners)	<b>CO<sub>2</sub> emissions per capita:</b> 8.9 t

“Supervisors in each jurisdiction need to explicitly clarify that ESG integration is fully in line with pension funds’ fiduciary duties.”

*André Laboul, Secretary General, International Organisation of Pension Supervisors (IOPS)*

## Policy context

Germany has a tradition in introducing and fostering sustainable development mechanisms, policy frameworks and practices. For instance, the Renewable Energy Sources Act, introduced in 2000, has led to a share of around 40% renewable energy sources in electricity generation installed capacity. In parallel, Germany is phasing out nuclear power and recently has decided to also phase out coal-fired power generation. However, progress has slowed in recent years and there is a risk that Germany is likely to miss its greenhouse gas reduction targets.

Germany’s economy is industry and manufacturing dominated, leading to a strong corporate sector. Compared to other markets, the German financial sector is relatively small. Finance activities are predominantly focused on corporate finance and banking and are less investment related. The public pension system is organised in a pay-as-you-go scheme, to a large extent without capital market investments. So far there are no encompassing legislative initiatives dedicated to sustainable finance and investment.

To better accompany its implementation of the EU Action Plan Financing Sustainable Growth, in March 2019 the German government set up an advisory committee on sustainable finance which is expected to publish a working programme in October 2019. The committee’s work has been divided into the following work streams: sustainable finance strategy and communication, finance market stability and risk management, disclosure and end consumer/client (institutional and retail).

## The Fiduciary Duty roadmap for Germany<sup>51</sup>

While fiduciary duty is not a clear legal term under German jurisdiction, duties to pursue the best interest of the end investor exist in the Capital Investment Code (Kapitalanlagegesetzbuch-KAGB) and the prudent person principle is embedded in the Pension Insurance Act (Versicherungsaufsichtsgesetz-VAG). The German roadmap outlines recommendations around government leadership in sustainable finance, pension fund and fund managers’ regulatory clarification and ESG disclosure.

<sup>51</sup> Available at: <https://www.unpri.org/sustainable-markets/fiduciary-duty>.



## Priority recommendations and regulatory developments

Roadmap recommendation	Progress made and next steps
<p><b>Government leadership</b></p> <p>The federal government should send strong signals highlighting the importance of sustainable finance. Government-related funds should also demonstrate leadership.</p>	<p>To better accompany the new and encompassing developments coming from the European Commission, namely the EU Action Plan Financing Sustainable Growth, in March 2019 the German government has set up an advisory committee on sustainable finance which is expected to publish a work programme in October 2019.</p> <p>This work programme should include dated and quantified objectives and commitments to implement the sustainable finance strategy.</p>
<p><b>Institutional investors</b></p> <p>Legal clarity and consistency:</p> <p>The prudent person principle embedded in the Pension Insurance Act (Versicherungsaufsichtsrecht – VAG) will be amended as part of the transposition of the revised EU Institutions for Occupational Retirement Provision (IORP II) Directive. As part of this transposition, the Ministry of Finance should propose an amendment to the Pension Insurance Act to clarify that all institutional investors should consider ESG issues financially material.</p> <p>Preparation for upcoming EU Directives:</p> <p>Tools, education and best practice case studies should be provided to German IORPs (Pensionfonds, Pensionkassen) to help them prepare for the ESG aspects of IORP II and the Shareholder Rights Directive.</p> <p>New defined contribution schemes should publicly commit to responsible investment, as well as consider and respond to the preferences of scheme members.</p> <p><b>Fund managers</b></p> <p>BaFin should issue guidance to fund managers clarifying that the Capital Investment Code (Kapitalanlagegesetzbuch – KAGB) requires consideration of material ESG issues.</p>	<p>The recommendation to provide legal clarity has been superseded by EU-wide developments. The EU has continued to prioritise the issue of fiduciary duties, in particular:</p> <ul style="list-style-type: none"> <li>• The new regulation on sustainability-related disclosures in the financial services sector requires investors to disclose details of their policies on the integration of financially material ESG risks.</li> <li>• In addition, the European Supervisory Authorities have provided advice to the European Commission on amendments to the delegated acts underpinning MiFID II, Solvency II, IDD, UCITS and AIFMD to clarify that ESG is a component of governance, risk management and disclosure.</li> </ul> <p>These rules are expected to come into force in due course.</p>
<p><b>Implementation of the CSR Directive</b></p> <p>The German Federal Ministry of Justice and Consumer Affairs (BMJV) should issue guidance to public interest entities complying with the new requirements, including that:</p> <ul style="list-style-type: none"> <li>• For financials, investments are in scope for their reporting. Where possible, this should be aligned with upcoming reporting requirements under IORP II and the Shareholder Rights Directive.</li> <li>• For non-financial corporations, investments such as pension schemes and contractual trust agreements are in scope for reporting.</li> </ul> <p>The German Parliament should monitor the implementation of amendments to the Handelsgesetzbuch (commercial law code) to ensure high-quality disclosure of ESG factors with clear links between ESG factors and a company's business model and risk factors; and to allow for investor comparability by industry, portfolio and across time-series.</p>	<p>The NFRD is likely to be revised under the new European Commission mandate (2019–2024).</p>

# JAPAN

	<b>Japan in 2018</b>	<b>Population:</b> 126.53 million
	<b>GDP:</b> 4.97 trillion USD	<b>Over 65 years:</b> 27.47%
	<b>Per capita GDP:</b> 39,287 USD	<b>GINI coefficient:</b> 0.34
	<b>Market cap:</b> 5.3 trillion USD	<b>CO<sub>2</sub> emissions:</b> 1,147 Mt
	<b>PRI signatories:</b> 75 (20 asset owners)	<b>CO<sub>2</sub> emissions per capita:</b> 9 t

“As a universal owner, instead of trying to beat the market, our responsibility at GPIF is to make capital markets more sustainable”

*Hiro Mizuno, CIO, GPIF*

## Policy context

In April 2019, at the fifth meeting on a Long-Term Strategy under the Paris Agreement as Growth Strategy, Prime Minister Shinzo Abe stated: “We need to produce disruptive innovation that is not a mere extension of existing technologies so as to stand firm against the global issue of climate change and realise the ultimate vision of a carbon-free society.”

The government considers sustainable investment an opportunity for future growth in Japan and plans to publish guidelines on green investment for financial institutions, following the one for non-financial corporations. Keidanren, a major industry association, has set up an internal committee that focuses on SDG policies. The Japan Stock Exchange (JPX) published the Revised Japan Corporate Governance Code in June 2018 aiming to enhance board effectiveness. JPX also established a Sustainability Committee that directly reports to the group’s CEO to promote ESG integration.

The Financial Services Agency (FSA) revised the Japan Stewardship Code in 2017 and also revised the Corporate Governance Code together with JPX in 2018. The new version of the Stewardship Code requires the following:

- Asset owners engage in stewardship activities as much as possible in order to secure the interests of the ultimate beneficiaries.
- Asset managers identify specific circumstances that may give rise to conflicts of interest which may significantly influence the exercise of voting rights and/or dialogue with companies, establish governance structures and strengthen governance mechanisms.
- Institutional investors disclose voting records for each investee company on an individual agenda item basis.

The revised Corporate Governance Code includes a definition of the role of corporate pension funds as asset owners. This principle highlights the link between corporate pension funds and their sponsors in ensuring that corporate pension funds have the knowledge to perform their duty of high-quality stewardship. Because the management of corporate pension funds impacts stable asset formation for employees’ and companies’ own financial standing, companies should implement and disclose measures to improve human resources and operational practices, such as the recruitment or assignment of qualified persons, in order to increase the investment management expertise of corporate pension funds (including stewardship activities such as monitoring asset managers), thus making sure that corporate pension funds perform their roles as asset owners. Companies should ensure that conflicts of interest which could arise between pension fund beneficiaries and companies are appropriately managed.

The Ministry of Economy, Trade and Industry (METI) published a report on SDG Management / ESG Investment in 2018 and a Guidance for Collaborative Value Creation in 2017 to encourage dialogue between investors and companies.

The Ministry of the Environment has also released a number of programmes and guidance on the topics of TCFD Scenario analysis, environmental reporting, environmental disclosure to improve ESG investment and green bonds.

The FSA, the METI and the Ministry of the Environment supported the establishment of an industry-led TCFD consortium. The consortium aims to facilitate constructive dialogue between investors and companies on climate-related financial disclosures recommended by the TCFD. Japan has the largest number of TCFD supporters globally and one-third of its supporters are non-financial corporations.

### The Fiduciary Duty roadmap for Japan<sup>52</sup>


The Japan roadmap sets out recommendations in five categories: stewardship and engagement, corporate governance, ESG disclosure and guidance for pension schemes, corporate disclosure and asset owner leadership.

## Priority recommendations and regulatory developments

Roadmap recommendation	Progress made and next steps
<p><b>Stewardship and engagement</b></p> <p>The FSA should provide enhanced oversight of the Stewardship Code. Japanese regulation should provide for mandatory disclosure of proxy voting records. Corporate plans should be encouraged to sign the Stewardship Code.</p>	<p>After the FSA revised the Stewardship Code in 2017, institutional investors are required to disclose the result of their voting rights for each investee companies. The FSA promotes the understanding of the stewardship code to corporate pension funds and encourages them to participate in stewardship activities.</p>
<p><b>Corporate governance</b></p> <p>The FSA should review the Corporate Governance Code on a triennial basis. It should seek improved disclosure of key ESG issues under the code (such as cross-shareholding) and continue pressure to enhance corporate governance expectations.</p>	<p>FSA and JPX revised the Corporate Governance Code in 2018. Asset owners including corporate pension funds will be required to adopt an oversight role in stewardship activities. The revised Corporate Governance Code recommends that investors and companies deepen their engagement on cross-shareholding (although these have decreased recently, the ratio of voting rights accounted for by cross-shareholding remains high). Companies need to assess cross-shareholding, and clearly disclose and explain the results of this assessment after specifically examining the purpose, benefits and risks of each holding.</p> <p>In 2019, FSA revised the corporate disclosure regulation to improve the disclosure of corporate governance-related information. The disclosure of cross-shareholding has been enhanced and the number of the disclosures of those engaged in cross-shareholding increased from 30 to 60.</p>
<p><b>ESG disclosure and guidance for pension schemes</b></p> <p>The Ministry of Health, Labour and Welfare (MHLW) should require pension schemes to disclose how they consider ESG issues in their investment processes and whether they are signatories to the Stewardship Code.</p>	<p>MHLW revised the guidelines on the roles and responsibilities of asset managers related to defined benefit corporate pensions in 2018 and added a language of consideration of ESG factors for the selection and appointment of asset managers and a preference for those who have adopted the stewardship code.</p>
<p><b>Corporate disclosure</b></p> <p>a) The Ministry of Economy, Trade and Industry (METI) and the FSA should review the quality and comparability of the corporate disclosure of material ESG information.</p> <p>b) JPX should issue ESG guidance for listed companies.</p>	<p>METI published the Ito Review 2.0 report and the Guidance for Collaborative Value Creation including its methodology on how to disclose ESG information. The advanced level corporations are expected to disclose ESG-related information in their integrated report.</p>
<p><b>Asset owner leadership</b></p> <p>GPIF, given its scale, size and influence, should lead in establishing market norms on stewardship, engagement and corporate governance.</p>	<p>GPIF revised their investment principles in 2017, incorporating ESG issues into the principles. Since 2016 they have issued an Annual Stewardship Activities Report.</p>

<sup>52</sup> Available at: <https://www.unpri.org/fiduciary-duty/fiduciary-duty-in-the-21st-century-japan-roadmap/262.article>.

# SOUTH AFRICA

	<b>South Africa in 2018</b>	<b>Population:</b> 57.78 million
	<b>GDP:</b> 366.3 billion USD	<b>Over 65 years:</b> 5.48%
	<b>Per capita GDP:</b> 6,340 USD	<b>GINI coefficient:</b> 0.62
	<b>Market cap:</b> 865.33 billion USD	<b>CO2 emissions:</b> 414 Mt (provisional data)
	<b>PRI signatories:</b> 61 (9 asset owners)	<b>CO2 emissions per capita:</b> 7.4 t

“A failure to take into account risks associated with [ESG] factors such as climate change, which may be relevant to the likely long-term performance of a specific investment, or the fund’s investments as a whole, is likely to amount to a breach of the duty of care and diligence”.

“Board members must therefore take all reasonable steps to acquire the information in relation to the risks associated with climate change as they may require, in order to make informed decisions when taking such risks into account when exercising the fund’s investment powers”.

*Fasken, 2019 Pension Fund legal opinion commissioned by Just Share and ClientEarth<sup>53</sup>*

## Policy context

The National Development Plan (NDP) aims to eliminate poverty and reduce inequality by 2030. Toward this goal, the NDP emphasises the importance of growing an inclusive economy, building capabilities, enhancing the capacity of the state and promoting leadership and partnerships throughout society. The NDP offers a long-term perspective on finance and investment priorities.

Recently, the UNDP conducted a study in which the SDGs were mapped against the objectives of the NDP. The mapping exercise concluded that 74% of the SDGs are reflected in South Africa’s National Development Plan, while 26% of the SDGs are not. Interestingly, of the 26% not reflected in the NDP, 73% are reflected in other sectoral strategies which means that they are part of the national planning system. Only 27% of those not reflected in the NDP do not appear elsewhere, mainly because they are not relevant to South Africa.

The South African National Treasury is currently concluding a project carried out in conjunction with the IFC regarding the development of a sustainable national financial system. The paper, which is expected to outline national targets and policy objectives with respect to finance and investment priorities, an appropriate approach to the just transition and targeted action toward achieving localised targets with respect to the SDGs, is due for release in October 2019.

Currently in effect, Regulation 28 under the Pension Funds Act sets out a number of principles which must at all times be applied by a fund and its board. One of these principles is that, “before making an investment in and while invested in an asset, [the board must] consider any factor which may materially affect the sustainable long-term performance of the asset including, but not limited to, those of an environmental, social and governance character”. This principle must also be adhered to by anyone to whom any investment-related powers and functions of the fund are delegated, for example asset managers and asset consultants.

The Financial Sector Conduct Authority (FSCA) recently published FSCA Communication 1 of 2019 (PFA) together with a Guidance Notice on Sustainability of Investments and Assets in the context of a retirement fund’s investment policy statement. The Guidance Notice provides guidance on some of the essential aspects of sustainable investments that the FSCA expects a fund to include in its investment policy statement. The Guidance Notice also sets out the FSCA’s expectations regarding certain disclosure and reporting requirements related to sustainability.

The field of integrated reporting in the country continues to grow and develop, with the King’s Code of Corporate Governance incorporated into listing requirements for the JSE as far back as 2010, and additional integrated reporting requirements put in place by the regulator in recent years.

## The Fiduciary Duty roadmap for South Africa<sup>54</sup>


Earlier in 2019, a shareholder activism organisation commissioned a legal opinion for South African pension funds regarding the role of trustees with respect to climate change. The opinion built on the work related to the modern interpretation of fiduciary duty and found unequivocally that failure to consider material financial risks arising from climate change would likely amount to a breach of duty by the board of a pension fund, under both the common law principles and Regulation 28 of the PFA. This interpretation aligns with the recommendations set out in the original Fiduciary Duty Roadmap for the country and reflects the growth and development of the market with respect to the role of trustees in responsible investment. Specific developments have been seen across all four areas of recommendation set out in the South African roadmap, namely: regulatory guidance, enhanced stewardship, investor education and corporate reporting.

<sup>54</sup> Available at: <https://www.unpri.org/fiduciary-duty/fiduciary-duty-in-the-21st-century-south-africa-roadmap/263.article>.

## Priority recommendations and regulatory developments

Roadmap recommendation	Progress made and next steps
<p><b>Regulatory guidance</b></p> <p>a) The 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.</p> <p>b) The FSB should review investment manager mandates to ensure that they reflect the expectations for investment practice set out in Regulation 28.</p> <p>c) South African industry associations and the FSB should provide practical guidance for trustees interacting with investment consultants on ESG integration.</p>	<p>In June 2019, the Financial Sector Conduct Authority (FSCA) (formerly the FSB) released a Guidance Note on the Sustainability of Investments, along with a communication explaining how investors are expected to apply it.</p> <p>The regulator has noted that there would be a concerted effort put toward drastically decreasing the number of standalone funds in the market over the next few years – which also aligns to the roadmap recommendations.</p> <p>The Guidance Note reiterates the need for investors to produce appropriate investment policy statements, which must take into consideration all factors that may impact the sustainability of investments – including, but not limited to, ESG factors. The Guidance Note also provides investors with both a definition of sustainability as well as with examples of ESG issues. The Guidance Note is not mandatory, but instead sets out best practice guidelines and ‘expectations’ from the regulator. The idea is to nudge the market toward the application of best practice principles, rather than prescribe specific actions.</p> <p>There are discussions taking place between investors and the regulator regarding the potential value that a revision of mandates could generate with respect to the effective implementation of the best practice guidelines presented in the Guidance Note.</p> <p>The FSCA should propose specific timelines for the implementation of the best practice principles outlined in the Guidance Note, with a deadline by which investors must be able to show substantial progress in this regard. This will allow for assessment of the ability of the market to self-regulate in this regard (i.e. test whether the ‘nudge’ has worked) and give FSCA a clear time at which further action can be taken if necessary (for example, converting the Guidance Note into a Directive, which is legally binding).</p> <p>The FSCA should revise investment mandate templates to incorporate ESG considerations, which will enable the more effective implementation of the recommendations presented in the Guidance Note.</p> <p>The FSCA should clarify the role of investment consultants in fulfilling the requirements of the Guidance Note.</p>
<p><b>Stewardship</b></p> <p>The Code for Responsible Investment in South Africa (CRISA) should be supported with more resourcing and a permanent secretariat to enable its work on stewardship and responsible investment in South Africa.</p>	<p>The ASISA Responsible Investment Committee has commissioned a review of CRISA, which is currently underway. It is expected that the review will result in the recommendation to establish a new entity (provisionally called the Centre for Responsible Investment in South Africa) which will act as the custodian of ESG and RI-related activities within the country and eventually the region. This entity will be resourced and dedicated to enforcement of CRISA commitments by investors. The Code itself is being expanded to include all asset classes. The ‘new and improved’ CRISA is expected to be ready for ‘launch’ in Q1 of 2020.</p> <p>CRISA should continue to work closely with ASISA and the IoDSA to ensure that it becomes and remains an effective hub for responsible investment activity in the country.</p>
<p><b>Investor education</b></p> <p>ESG issues should be a core competency in the National Qualification Framework for trustee training. Training and accreditation groups and industry organisations, such as Batseta and ASISA, should collaborate to provide training and raise market awareness of ESG investment approaches.</p>	<p>Batseta and ASISA offer ESG integration and RI training to trustees. The training is locally accredited.</p> <p>While Batseta and ASISA do offer RI training to trustees, there is definitely the scope to increase the availability of this instruction. PRI is currently working with these organisations to identify areas of potential collaboration.</p> <p>Batseta and ASISA should bolster their RI education offerings and promote trainings (i.e. marketing this training as core to fiduciary duty, to modify the perception of ESG as a ‘nice to have’).</p>
<p><b>Corporate reporting</b></p> <p>South African stakeholders, including the FSB and the Johannesburg Stock Exchange (JSE), should review the quality of the reporting of material ESG factors following the report of the international Financial Stability Board’s Task Force on Climate-related Financial Disclosures (TCFD).</p>	<p>Efforts in IR are ongoing, and the market has seen strides, especially with respect to the incorporation of Stewardship Codes into reporting requirements and the addition of non-financial reporting requirements to be listed on the JSE.</p> <p>Regulators and the JSE should consider incorporating TCFD into reporting requirements.</p>

# UNITED KINGDOM

	<b>United Kingdom in 2018</b>	<b>Population:</b> 66.49 million
	<b>GDP:</b> 2.825 trillion USD	<b>Over 65 years:</b> 18.65%
	<b>Per capita GDP:</b> 42,491 USD	<b>GINI coefficient:</b> 0.35
	<b>Market cap:</b> 3.64 trillion USD	<b>CO<sub>2</sub> emissions:</b> 371 Mt
	<b>PRI signatories:</b> 386 (55 asset owners)	<b>CO<sub>2</sub> emissions per capita:</b> 5.7 t

“New regulations commit UK occupational pension schemes for the first time to clearly and openly explain how they take account of Environmental, Social and Governance considerations, including climate change.”

*Guy Opperman, Pensions Minister*

## Policy context

While the UK is one of the largest historical contributors to climate change, it has also been a leader on climate action. The UK has reduced emissions by over 40% since 1990 while experiencing GDP growth of 70% over the same period. It became the first country to introduce long-term legally binding commitments to reduce emissions via the Climate Change Act of 2008.

Climate change continues to be an area of focus for the UK government and is embedded in a number of goals and strategies:

- Net zero (June 2019)<sup>55</sup> – Following the advice of the Advisory Committee on Climate Change, the UK government committed to reduce its greenhouse gas emissions to net zero by 2050.
- Clean Growth Strategy (October 2017)<sup>56</sup> – This is a set of policies and proposals that aim to deliver increased economic growth while cutting emissions. Key objectives under this strategy include developing world-renowned green finance capabilities, demonstrating international leadership in carbon capture usage and storage through investment and collaboration, improving the route to the market for renewable technologies and targeting total carbon prices in the power sector.
- UK Industrial Strategy (November 2017)<sup>57</sup> – One of the five core components of the industrial strategy involves boosting infrastructure investment, focusing on transport, housing and digital infrastructure.

<sup>55</sup> Available at: <https://www.gov.uk/government/news/uk-becomes-first-major-economy-to-pass-net-zero-emissions-law>.

<sup>56</sup> Available at: <https://www.gov.uk/government/publications/clean-growth-strategy>.

<sup>57</sup> Available at: <https://www.gov.uk/government/publications/industrial-strategy-building-a-britain-fit-for-the-future>.

In July 2019 the UK set out its Green Finance Strategy, which aims to align private sector financial flows with clean, environmental sustainability and resilient growth while strengthening the UK financial services sector’s competitiveness. It has three components:

**Greening finance** – Mainstreaming climate and environmental factors as a financial and strategic imperative:

- Establishing a shared understanding.
- Clarifying roles and responsibilities.
- Fostering transparency and embedding a long-term approach.
- Building robust and consistent green financial market frameworks.

**Financing green** – Mobilising private finance for clean and resilient growth:

- Establishing robust long-term policy frameworks.
- Improving access to finance for green investment.
- Addressing market barriers and building capability.
- Developing innovative approaches and new ways of working.

**Capturing the opportunity** – Cementing UK leadership in green finance:

- Consolidating the UK’s position as a global hub for green finance.
- Positioning the UK at the forefront of green financial innovation and data and analytics.
- Building skills and capabilities on green finance.

**The Fiduciary Duty roadmap for the UK<sup>58</sup>**

Fiduciary duty requires investors to consider long-term value drivers in investment processes. ESG factors are a core part of such an assessment. This understanding of fiduciary duty reflects the findings of the Law Commission in its report *Fiduciary Duties of Investment Intermediaries*,<sup>59</sup> which stated that “there is no impediment to trustees taking account of environmental, social or governance factors where they are, or may be, financially material”. It is not the origin of the factor, but rather its financial materiality, which is of relevance.

The Law Commission guidance draws a distinction between ESG integration and social investment strategies. The primary purpose in ESG integration is the delivery of a financial return. Social investment strategies also seek to achieve purposes which are not always related to the delivery of a financial return. Such strategies often involve a narrowing of the available investment universe through the screening of sectors or stocks on ethical grounds. As such, they can be distinguished from ESG integration.

**Priority recommendations and regulatory developments**

Roadmap recommendation	Progress made and next steps
<p><b>Investment regulations</b></p> <p>The Department for Work and Pensions (DWP) should revisit the Investment Regulations to clarify that the consideration of ESG factors is a core part of prudent investment decision making.</p>	<p>In September 2018 the DWP published amendments to the Investment Regulations requiring pension schemes’ Statements of Investment Principles (SIPs) to state how the scheme accounts for ESG factors. These regulations are effective from October 2019.</p> <p>The requirements apply to trust-based schemes with at least 100 members. An original proposal that “non-financial matters”, such as member views and real economy impacts, must also be included has been replaced with an optional policy on how these matters are addressed.</p> <p>TPR and the DWP should monitor compliance to ensure that changes to pension schemes’ SIPs are accompanied by behaviour changes and the effective incorporation of ESG issues into investment decision making.</p> <p>The DWP should, together with the FCA, produce guidelines on how schemes can integrate member views and preferences into their investment strategy.</p>
<p><b>Stewardship and engagement</b></p> <p>a) Regulation and guidance should provide for a Stewardship Duty to clarify that shareholder rights are assets to be used in the best interests of beneficiaries.</p> <p>b) The Financial Reporting Council should extend the Stewardship Code to explicitly incorporate ESG factors and continue to monitor and publicly disclose the quality of reporting by signatories against the Code.</p>	<p>The revised Investment Regulations require pension schemes to state their policy (if any) on stewardship. Furthermore, the UK implemented the revised Shareholder Rights Directive in June 2019, which requires asset managers and asset owners to disclose, on a comply or explain basis, an engagement policy which includes its approaches to ESG and voting.</p> <p>The FRC is expected to publish an updated Stewardship Code in November 2019. The revised version is expected to explicitly incorporate material ESG factors across all asset classes.</p> <p>While the Investment Regulations and the revised Shareholder Rights Directive increase the expectations for investors to disclose their stewardship policies and activities, they do not face an explicit requirement to engage in stewardship.</p> <p>The FRC should ensure that the reporting framework under the revised code is focused on stewardship outcomes, as well as processes and activities. The FRC should further ensure that the tiering of signatories under the revised code is based upon the quality of underlying stewardship activities rather than the quality of disclosures.</p>

58 Available at: <https://www.unpri.org/fiduciary-duty/fiduciary-duty-in-the-21st-century-uk-roadmap/264.article>.

59 Available at: <https://www.lawcom.gov.uk/project/fiduciary-duties-of-investment-intermediaries/>.



## Priority recommendations and regulatory developments


Roadmap recommendation	Progress made and next steps
<p><b>Investment consultants</b></p> <p>a) The Financial Conduct Authority (FCA) should expand its oversight of investment advice to include that provided by investment consultants in relation to ESG factors.</p> <p>b) The Pensions Regulator (TPR) should provide guidance on the interaction of trustees with investment consultants to help trustees review advice and performance.</p>	<p>In February 2019 the FCA requested an expanded regulatory remit from HM Treasury to include all of the main activities of investment consultants, which would include ESG-related services, following an investigation into competition issues within the industry.</p> <p>In June 2019 the Competition and Markets Authority (CMA) introduced a rule requiring trustees to set objectives for their investment consultants. In July 2019 TPR published a draft guide for trustees on how to set such objectives.</p> <p>These changes follow a CMA investigation into competition issues within the investment consultancy and fiduciary management industry. The CMA recommended the extension of FCA's regulatory perimeter to include all the main activities of investment consultants, including ESG issues, though this was not considered part of the investigation. The CMA also recommended that TPR develop guidance to support pension scheme trustees in seeking and using enhanced information.</p> <p>HM Treasury should approve the expansion of the FCA's regulatory perimeter. The FCA's oversight should explicitly include service provision relating to ESG issues and climate change in particular, given existing shortcomings<sup>60</sup> and the increasing expectations<sup>61</sup> on asset owners in this area.</p> <p>ESG issues should be included in core service provision as part of investment consultant fee disclosures.</p>
<p><b>Corporate reporting</b></p> <p>Through the implementation of the Non-Financial Reporting Directive, the development of standardised and comparable approaches for reporting on material ESG factors relevant to investors.</p>	<p>The UK has implemented the NFRD and issued guidance on how companies can meet these and other ESG reporting requirements under the Companies Act. The UK's Green Finance Strategy also contains an expectation that all listed companies and large asset owners will disclose in line with TCFD by 2022.</p> <p>FRC guidance published in July 2018 informs companies of how they can ensure their Strategic Report and Director's Report comply with the Companies Act and NFRD. The Green Finance Strategy, published in July 2019, states that an interim report will be published in 2020 on the progress of TCFD implementation, and a joint taskforce of UK regulators will explore the mandating of TCFD reporting.</p> <p>Regulators should continue to monitor levels of TCFD reporting and ensure that various efforts to produce TCFD guidance documents remain aligned.</p> <p>The new Impact Investing Institute should work with existing organisations such as the PRI, the Impact Management Project and the Green Finance Institute to develop guidelines for impact reporting for companies and investors. This should also inform reporting under the revised Stewardship Code.</p>
<p><b>Scheme Governance</b></p> <p>a) The governance arrangements for defined-contribution (DC) schemes should be strengthened and provide for enhanced consideration of ESG factors.</p> <p>b) Schemes should be required to reflect on the impact of their scale on governance quality and, where necessary, consider consolidation.</p>	<p>In April 2019 the FCA published a consultation on extending the remit of Independent Governance Committees to include oversight of ESG and other material issues, stewardship and member preferences.</p> <p>The FCA's proposed changes to the remit of IGCs attempts to bring contract-based pensions in line with the DWP's revised Investment Regulations for trust-based pensions. However, given structural differences between the two schemes, there are questions whether these changes go far enough.</p> <p>Alongside broadening the remit of IGCs as proposed in the consultation, the FCA should address issues<sup>62</sup> with the independence, accountability, reporting and skills of IGCs as part of its review of the effectiveness of IGCs during the 2019/20 business year.</p> <p>In February 2019 the DWP published a consultation on introducing a requirement for small schemes to carry out a triennial assessment on whether they should consolidate into a larger scheme.</p> <p>In July 2019 TPR published a further consultation on removing the barriers to consolidation among small schemes.</p> <p>The DWP's efforts to encourage consolidation among pension schemes is linked in part to the government's Patient Capital Review, which noted that UK pension funds were heavily invested in listed equities and bonds with little investment in alternatives. The proposals to encourage consolidation were accompanied by other measures to boost pension fund allocation to illiquid investments such as infrastructure.</p> <p>The DWP should introduce the proposed requirement for schemes to carry out a triennial assessment on the benefits of consolidation. This requirement should go beyond the proposed threshold of schemes with GBP 10 million in assets to also include medium-sized and larger schemes that can also benefit from consolidating. The DWP should revisit this policy in the event that this does not lead to an increase in consolidation.</p>

<sup>60</sup> Available at: <https://www.unpri.org/sustainable-financial-system/investment-consultants-services-review/571.article>.

<sup>61</sup> For example, the amended Investment Regulations and the Green Finance Strategy's expectation that large asset owners will disclose in line with the TCFD recommendations by 2022.

<sup>62</sup> Available at: [https://www.unpri.org/Uploads/e/v/1/priletterigcsandcontractpensions\\_783269.pdf](https://www.unpri.org/Uploads/e/v/1/priletterigcsandcontractpensions_783269.pdf).

# UNITED STATES

	<b>United States in 2018</b>	<b>Population:</b> 327.17 million
	<b>GDP:</b> 20.49 trillion USD	<b>Over 65 years:</b> 15.8%
	<b>Per capita GDP:</b> 62,641 USD	<b>GINI coefficient:</b> 0.39
	<b>Market cap:</b> 30.44 trillion USD	<b>CO<sub>2</sub> emissions:</b> 4,833 Mt
	<b>PRI signatories:</b> 474 (47 asset owners)	<b>CO<sub>2</sub> emissions per capita:</b> 15 t

“Fundamentally, the history of securities law shows that we will need mandatory rules to address ESG issues. Voluntary disclosures on a case-by-case basis produce a selection effect where only the least problematic companies will change, which is why mandatory disclosure is the basic bargain of participating in our markets. One-off disclosures produce information investors cannot compare across companies and industries, making it harder to hold corporate managers accountable. It is vital that we bring more transparency to these crucial sustainability issues in time to do something meaningful about them.”

*US SEC Commissioner Robert Jackson*

## Policy context

In the US, the conversation around climate change and the role of the capital markets in helping to support broader societal and economic change is polarised. Because of this, political shifts have a dramatic impact on both federal and state policies. In November 2018, there was a shift in leadership in the House

of Representatives that provided new opportunities to advance policies that support sustainable investment. Leaders in the House have taken advantage of those opportunities to introduce, debate and cast votes on positive legislation.

Legislative change in the US, however, requires consensus among the House, Senate and President. This is unlikely unless and until the leadership of all three bodies embraces the need for action to mandate that fiduciaries integrate ESG factors into investment decisions. Due to political polarisation, this will likely happen either because of a change in the political party of the leadership or because we reach a tipping point at which society, at large, demands clear policy responses to crises such as climate change or inequality.

The public debate in the US has begun to shift with respect to the role that the public expects businesses and financial entities to play in society. The business community has begun to recognise and respond to this shift. For example, in August 2019 the Business Roundtable, a lobbying organisation whose members are CEOs of the largest companies in the United States, issued a statement signed by 181 corporate CEOs which expressed a commitment to consider the interests of stakeholders beyond shareholders, including employees and communities, into their business decisions. It is possible that this marks a shift that will create opportunities for more proactive collaboration with business interests to promote positive policy changes in fiduciary duty and ESG integration more broadly.

US regulators, including the Securities and Exchange Commission (SEC) and Department of Labor (DOL), interpret, implement and enforce the laws within their jurisdiction. The DOL, among other responsibilities, oversees fiduciaries for private sector retirement plans (ERISA fiduciaries), and enforces the laws that define their obligations in advising clients on retirement. The SEC has broad authority over the laws applicable to capital markets’ activity and investor protections.

The DOL periodically releases policy pronouncements related to the obligations of ERISA fiduciaries that have caused confusion among those responsible for overseeing private sector retirement plans. The most recent, a Field Assistance Bulletin (FAB) from 2018, reiterated the DOL’s longstanding position that fiduciaries are obliged to consider ESG factors as part of investment decisions “[t]o the extent ESG factors, in fact, involve business risks or opportunities that are properly treated as economic considerations themselves”. At the same time, the DOL stated that fiduciaries “must avoid too readily treating ESG issues as being economically relevant to any particular investment choice”. While the FAB did not reflect a substantive change to the DOL’s position that material economic factors, including material ESG factors, are to be considered by investment fiduciaries, the explanatory language in the Bulletin created uncertainty for fiduciaries of private pension plans.

As the capital markets regulator, the SEC is responsible for implementing statutory requirements related to corporate disclosure. Fiduciaries’ ability to effectively integrate ESG factors

into investment decisions depends upon access to consistent, comparable ESG data. To date, the Commission has ignored calls from investors to implement a comprehensive ESG disclosure mandate applicable to public companies. In August of 2019, the Commission issued a rule proposal that, if finalised as proposed, will change the rules related to corporate disclosures by giving public companies substantially more discretion as to the nature of their risk disclosures. The rule proposal would establish a principles-based disclosure regime for human capital matters, though it fails to address climate change.

### Fiduciary duty roadmap for the US<sup>63</sup>

The United States is the world’s largest economy and the PRI’s largest market. US investors are increasingly acknowledging the long-term value of incorporating ESG factors. Investment managers and asset owners see the long-term opportunities of ESG, but there are significant barriers to enacting policies that support the growth of ESG integration and clarity around fiduciary duty.

## Priority recommendations and regulatory developments

Roadmap recommendation	Progress made and next steps
<p><b>Investor education</b></p> <p>Trustee boards should ensure capacity and competence on ESG issues. This should be industry led.</p>	<p>The PRI Academy launched an online trustee course at the end of 2017 and has trained 338 trustees, pension fund staff and investment consultants thus far.</p> <p>In addition, the PRI recently launched and is piloting the RI Review Tool, intended for use by asset owner trustees and boards to review their responsible investment strategy, ambitions and implementation. The RI Review Tool is part of the Sustainable Financial System programme, as it was identified that there was a significant gap between the commitments made by asset owners and their implementation (as reported to the PRI).</p> <p>Asset owner trustees and boards should use the RI Review Tool and PRI Academy courses to increase education and competence of ESG issues in their organisations.</p>
<p><b>Corporate Reporting</b></p> <p>The Securities and Exchange Commission (SEC) should update Regulation S-K to ensure the high-quality disclosure of ESG factors.</p>	<p>A petition was submitted to the SEC in October 2018 calling on the Commission to require ESG disclosure by issuers in Regulation S-K. The SEC has taken no actions in response to this petition. Concerns over recently proposed changes to Regulation S-K include its use of a principle-based approach (instead of line-item disclosures) and a lack of climate risk disclosure. This leaves investors with inconsistent information and a lack of transparency.</p> <p>The Climate Risk Disclosure Act of 2019, which would require public companies to disclose information on their climate-related risks, passed the House Financial Services Committee. Similar legislation was introduced in the Senate. It is unlikely this bill will advance in the near-term. Many presidential candidates are co-sponsors of this legislation and are taking up climate risk disclosure in their campaigns.</p> <p>Congress should mandate that the SEC take action to require the disclosure of ESG factors in public companies’ Regulation S-K filings.</p>
<p><b>Investment consultants</b></p> <p>Industry stakeholders should build on existing guidance to plan fiduciaries and trustees on the integration of ESG factors into investment consultant services.</p>	<p>The PRI surveyed asset owners and investment consultants in 2017, finding most were failing to consider ESG issues in their investment practices. The PRI recently published “Investment consultants and ESG: An asset owner guide”<sup>64</sup>.</p> <p>Investment consultants should, in fulfilling their obligations to clients, integrate material ESG factors in their services to maximise investment opportunities.</p>
<p><b>Stewardship and engagement</b></p> <p>The Securities and Exchange Commission (SEC) has considered changes to the proxy process since 2017.</p>	<p>The SEC recently passed guidance related to proxy voting. The PRI’s view is that this guidance is harmful to investors as it could create additional costs for fiduciaries in fulfilling their proxy voting obligations and creates additional litigation risk for proxy advisors. The Commission also indicated plans for further reforms to proxy voting regulations that will impact which proposals are admitted for inclusion on company’s proxies and could impose further burdens on proxy advisors.</p> <p>The SEC should retain current regulations and staff-level interpretations related to proxy voting.</p>

63 Available at: <https://www.unpri.org/fiduciary-duty/fiduciary-duty-in-the-21st-century-us-roadmap/265.article>.

64 Available at: <https://www.unpri.org/asset-owners/investment-consultants-and-esg-an-asset-owner-guide>.

# FIDUCIARY DUTY IN THE 21ST CENTURY PROGRAMME

In January 2016, the PRI and UNEP FI, with the generous financial support of The Generation Foundation, launched a four-year project to end the debate on whether fiduciary duty is a legitimate barrier to the integration of environmental, social and governance issues in investment practices and decision making.

This followed the original publication in September 2015 of *Fiduciary Duty in the 21st Century* by the PRI, UNEP FI, UNEP Inquiry and UN Global Compact. The 2015 report concluded that “Failing to consider all long-term investment value drivers, including ESG issues, is a failure of fiduciary duty”. It also acknowledged that despite significant progress, many investors had yet to fully integrate ESG issues into their investment decision-making processes.

Accordingly, the project had three main components:

- Working with investors, governments and intergovernmental organisations, to develop and publish an international statement on fiduciary duty, which includes the requirement to integrate ESG issues into investment processes and practices.
- Publishing and implementing roadmaps on the policy changes required to achieve the full integration of ESG issues in investment processes and practices across eight countries.
- Extending the research into fiduciary duties – and, more broadly, investor duties – to six Asian markets: China, Hong Kong SAR, India, Korea, Malaysia and Singapore.

Between 2016 to 2019, the project has<sup>65</sup>:

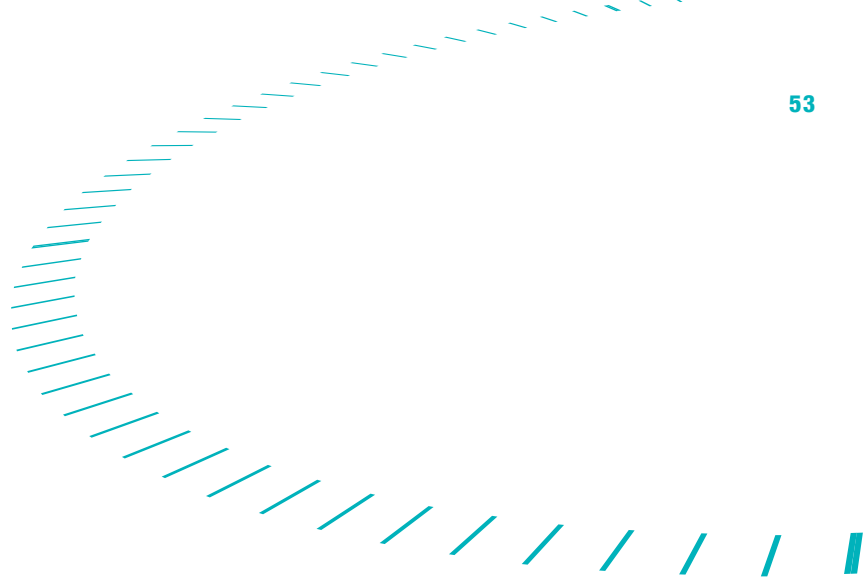
- Engaged with over 400 policy makers and investors to raise awareness of the importance of ESG-issues to the fiduciary duties of investors.
- Published the *Global Statement on Investor Obligations and Duties*, which has now been signed by 124 signatories from 22 countries.<sup>66</sup>
- Published and started to implement roadmaps on the policy changes required to achieve full integration of ESG issues into investment processes and practices across 11 countries (Australia, Brazil, Canada, China, France, Germany, Ireland, Japan, South Africa, UK and US).
- Extended the research into fiduciary duties – and, more broadly, investor duties – to six Asian markets: China, Hong Kong SAR, India, Korea, Malaysia and Singapore
- Published ten related reports.
- Engaged with the European Commission and the HLEG (European Commission High Level Expert Group on Sustainable Finance<sup>67</sup>) to help formulate recommendations on the clarification of investor duties throughout the European Union.
- Hosted over 20 workshops and conferences with investors and regulators in 15 countries to discuss regulatory clarification and investor practice on ESG integration as part of their fiduciary duty.

In November 2017, the project was recognised by Investments and Pensions Europe with a gold award for Outstanding Industry Contribution.

<sup>65</sup> See, further, <https://www.fiduciaryduty21.org/>.

<sup>66</sup> Available at: <https://www.fiduciaryduty21.org/investor-statement.html>. For signatories, see <https://www.fiduciaryduty21.org/signatories.html>.

<sup>67</sup> Available at: [https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance\\_en](https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_en).



## Country Roadmaps

1. [Australia](#)
2. [Brazil](#) ([English](#)) ([Portuguese](#))
3. [Canada](#) ([English](#)) ([French](#))
  - [Alberta](#)
4. [China](#) ([English](#)) ([Chinese](#))
5. [France](#) ([English](#)) ([French](#))
6. [Ireland](#)
7. [Germany](#) ([English](#)) ([German](#))
8. [Japan](#) ([English](#)) ([Japanese](#))
9. [South Africa](#)
10. [United Kingdom](#)
11. [United States](#)
  - [Ohio](#)

Additional jurisdiction analysis:

- [Investor Obligations and Duties in Six Asian Markets](#) ([English](#)) ([Chinese](#))

## Additional Project Related Publications

1. [ESG Data in China](#) ([English](#)) ([Mandarin](#))
2. [Aligning investors with sustainable finance: a focus on the OECD](#)
3. [Untangling Stakeholders for Broader Impact: ERISA Plans and ESG Incorporation](#)
4. [Financial Performance of ESG Integration in US Investing](#)
5. [Working towards a sustainable financial system: investment consultant services review](#)
6. [Aligning values: why corporate pension plans should mirror their sponsors](#) ([English](#)) ([Portuguese](#)) ([Japanese](#))
7. [Fiduciary Duty in the 21st Century Progress Report 2017](#)
8. [Addressing ESG factors under ERISA](#)
9. [Fiduciary Duty in the 21st Century \(2015\)](#)

# EVOLUTION OF FIDUCIARY DUTY:

## FROM A LEGAL CASE TO REGULATORY CLARIFICATION

**As depicted below, the rate of regulatory action on fiduciary duty and ESG issues has accelerated markedly in recent years.**

The Principles for Responsible Investment launches.

2005	2006	2009	2014	2015
<p>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.</p>		<p>UNEP Finance Initiative publishes Fiduciary Responsibility: Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment.</p>		<p><b>October</b> 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”.</p>

**July**

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”.

**September**

Fiduciary Duty in the 21st Century report launches. Concluding that: “Failing to integrate ESG factors is a failure of fiduciary duty”, it makes recommendations to policy makers, investors and service providers.



**January**

PRI and UNEP Finance Initiative launch the Fiduciary Duty in the 21st Century programme<sup>67</sup> – a three-year project to clarify investors’ duties and obligations on ESG integration in legislation and policy.

**June**

The Global Statement on Investor Obligations and Duties<sup>68</sup> launches to clarify that investor obligations and duties require the consideration of ESG issues in investment decisions and processes.

**August**

The People’s Bank of China, along with six other government agencies, issues the “Guidelines for Establishing the Green Financial System”.

**September**

Investor Duties and Obligations in 6 Asian Markets report launch.

**October**

UK Roadmap launch.

US Roadmap launch.

**December**

Australia Roadmap launch.

**March**

China Roadmap launch.

**May**

CMN, the Brazil National Monetary Council, replaces Resolution CMN 3792 with Resolution CMN 4661 requiring closed pension funds, supervised by Previc, to analyse ESG risks in their investment decisions.

**June**

Ireland Roadmap launch.

Ohio state Roadmap launch.

**September**

The UK DWP publishes amendments to the Investment Regulations requiring pension schemes’ Statements of Investment Principles (SIPs) to state how the scheme takes account of ESG factors, to be effective from October 2019.

**November**

France Roadmap launch.

**December**

OECD Roadmap launch.

**January**

The European Union High Level Expert Group on Sustainable Finance (HLEG) releases its final report.

**March**

The three EU law-making institutions, the European Parliament, the Council of the EU and the European Commission achieve political agreement on requiring ESG integration by financial market participants.

**April**

Abropp, the Brazil pension funds association, launches their Self-regulation Code of Corporate Governance, which requires that “pension funds always consider the balance between social and environmental responsibility and the return on investments”.

The Australian Prudential Regulation Authority (APRA) announces that it plans to update the investment governance standard (SP530) and guidance to provide clarity on the obligations of RSE licensees to take into account ESG factors when setting their investment strategies.

	2016	2017	2018	2019
	<p><b>January</b></p> <p>PRI and UNEP Finance Initiative launch the <u>Fiduciary Duty in the 21st Century programme</u><sup>67</sup> – a three-year project to clarify investors’ duties and obligations on ESG integration in legislation and policy.</p> <p><b>June</b></p> <p>The <u>Global Statement on Investor Obligations and Duties</u><sup>68</sup> launches to clarify that investor obligations and duties require the consideration of ESG issues in investment decisions and processes.</p> <p><b>August</b></p> <p>The People’s Bank of China, along with six other government agencies, issues the “Guidelines for Establishing the Green Financial System”.</p> <p><b>September</b></p> <p><u>Investor Duties and Obligations in 6 Asian Markets</u> report launch.</p> <p><b>October</b></p> <p><u>UK Roadmap</u> launch.</p> <p><u>US Roadmap</u> launch.</p> <p><b>December</b></p> <p><u>Australia Roadmap</u> launch.</p>	<p><b>January</b></p> <p><u>Canada Roadmap</u> launch.</p> <p><b>February</b></p> <p><u>Brazil Roadmap</u> launch.</p> <p><b>April</b></p> <p><u>South Africa Roadmap</u> launch.</p> <p><b>May</b></p> <p><u>Japan Roadmap</u> launch.</p> <p><b>July</b></p> <p><u>Germany Roadmap</u> launch.</p> <p>The European Commission’s High-Level Expert Group on Sustainable Finance publishes its interim report recommending EU-wide clarification of fiduciary duties. The OECD’s report Investment Governance and the Integration of Environmental, Social and Governance Factors makes similar recommendations.</p>		<p><b>January</b></p> <p>The European Union High Level Expert Group on Sustainable Finance (HLEG) releases its final report.</p> <p><b>March</b></p> <p>The three EU law-making institutions, the European Parliament, the Council of the EU and the European Commission achieve political agreement on requiring ESG integration by financial market participants.</p> <p><b>April</b></p> <p>Abropp, the Brazil pension funds association, launches their Self-regulation Code of Corporate Governance, which requires that “pension funds always consider the balance between social and environmental responsibility and the return on investments”.</p> <p>The Australian Prudential Regulation Authority (APRA) announces that it plans to update the investment governance standard (SP530) and guidance to provide clarity on the obligations of RSE licensees to take into account ESG factors when setting their investment strategies.</p> <p><b>June</b></p> <p>The Canada Expert Panel on Sustainable Finance releases its final report.</p> <p>The EU Technical Expert Subcommittee for the Taxonomy publishes its report on mitigation and adaptation.</p> <p>The South Africa Financial Sector Conduct Authority (FSCA) (formerly the FSB) releases a Guidance Note on the Sustainability of Investments, which reiterates the need for investors to produce appropriate investment policy statements, which must take into consideration all factors that may impact the sustainability of investments – including, but not limited to, ESG factors.</p> <p><b>October</b></p> <p>The UK FRC is expected to publish an updated Stewardship Code, which explicitly incorporates material ESG factors across all asset classes.</p>

67 Available at: <https://www.fiduciaryduty21.org/>.

68 Available at: <http://www.fiduciaryduty21.org/investor-statement.html>.

# GLOSSARY

<b>ABRAPP</b>	Brazil Pension Funds Association	<b>GPIF</b>	Government Pension Investment Fund, Japan
<b>ACPR</b>	French Prudential Supervision and Resolution Authority	<b>HLEG</b>	High-Level Expert Group on Sustainable Finance
<b>ACSI</b>	Australian Council of Superannuation Investors	<b>IGC</b>	Independent Governance Committees
<b>AMAC</b>	Asset Management Association of China	<b>IoDSA</b>	Institute of Directors in South Africa
<b>AMEC</b>	Brazil Association of Capital Market Investors	<b>IOPS</b>	International Organisation of Pension Supervisors
<b>AMF</b>	French Securities Market Authority	<b>IORP</b>	Institutions for Occupational Retirement Provision
<b>APRA</b>	Australian Prudential Regulation Authority	<b>IOSCO</b>	International Organization of Securities Commissions
<b>ASIC</b>	Australian Securities and Investments Commission	<b>JSE</b>	Johannesburg Stock Exchange
<b>ASISA</b>	Association for Savings and Investment South Africa	<b>JPX</b>	Japan Stock Exchange
<b>ASX</b>	Australian Securities Exchange	<b>METI</b>	Japan Ministry of Economy, Trade and Industry
<b>CMN</b>	Brazil National Monetary Council	<b>MHLW</b>	Japan Ministry of Health, Labour and Welfare
<b>CRISA</b>	Code for Responsible Investment in South Africa	<b>MiFID</b>	Markets in Financial Instruments Directive
<b>CSA</b>	Canadian Standards Association	<b>NFRD</b>	Non-Financial Reporting Directive
<b>CSRC</b>	China Securities Regulatory Commission	<b>PREVIC</b>	Brazil Pension Funds Supervisor
<b>CVM</b>	Brazil Securities Exchange Commission	<b>RSE</b>	Registrable Superannuation Entity (Australia)
<b>DOL</b>	US Department of Labor	<b>SEC</b>	US Securities and Exchange Commission
<b>DWP</b>	UK Department for Work and Pensions	<b>SFAC</b>	Canadian Sustainable Finance Action Council
<b>ERAFP</b>	French Public Service Additional Pension Scheme	<b>SIP</b>	Statements of Investment Principles
<b>ERISA</b>	US Employee Retirement Income Security Act of 1974	<b>SIPP</b>	Statement of Investment Policies and Procedures
<b>FCA</b>	UK Financial Conduct Authority	<b>SUSEP</b>	Brazil Superintendence of Private Insurance
<b>FSA</b>	Japan Financial Services Agency	<b>TCFD</b>	Task Force on Climate-Related Financial Disclosures
<b>FSCA/FSB</b>	South Africa Financial Sector Conduct Authority (formerly the Financial Services Board)	<b>TPR</b>	The Pensions Regulator (UK)
<b>FRC</b>	UK Financial Reporting Council	<b>TSX</b>	Toronto Stock Exchange
<b>FRR</b>	French Public Pension Fund	<b>UCITS</b>	Undertakings for the Collective Investment in Transferable Securities
<b>GEGFS</b>	Guidelines for Establishing a Green Financial system		
<b>GHG</b>	Greenhouse gas		



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# ABOUT THE PROJECT PARTNERS

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For more information, see [www.unpri.org](http://www.unpri.org).

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