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ICGN Guidance on Investor Fiduciary Duties

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Established in 1995 and led by investors responsible for assets under management in excess of US $34 trillion, the International Corporate Governance Network (ICGN) is a leading authority on global standards of corporate governance and investor stewardship. We promote high standards of professional practice among companies and investors alike in their pursuit of long-term value creation contributing to sustainable economies world-wide. This is achieved through three core objectives:

- Influencing public policy through ICGN Principles: investor-led global standards for governance and stewardship.
- Connecting investors and companies at high quality events with unrivalled opportunities for networking, knowledge-sharing and collaboration.
- Informing high standards of corporate governance and investor stewardship practices through professional development support and dialogue.

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Preamble

The ICGN Guidance on Investor Fiduciary Duties addresses the alignment between investor fiduciary practices and fundamental fiduciary obligations. It addresses the perspective of investor fiduciaries (asset owners) who seek to preserve and enhance long term corporate value on behalf of their underlying beneficiaries.

Much has changed in the investment industry since the beginning of the 21st century, with further implications for investor fiduciaries. Corporate governance codes, investor stewardship codes, guidance and regulation continue to emerge around the world, reflecting unprecedented focus on the role of asset owners as investor fiduciaries.

The European Shareholder Rights Directive requires the mandatory disclosure of stewardship policies by investor fiduciaries. Asset owners must report publicly on how their investment strategy and stewardship approach contributes to the long-term performance of their assets, and requires asset managers to report to their clients on the same. The European Union's High Level Expert Group 2018 Report on Sustainable Finance clarifies that the fiduciary duty of investors should explicitly integrate material environmental social and governance (ESG) factors and long term sustainability. The review conducted by the Principles for Responsible Investment's (PRI)[1] in 2015 emphasised the importance of investor fiduciary duty and ESG in multiple jurisdictions around the world.

Fiduciary duty concepts are fundamental to informing investment practitioner views of risk and materiality, which extend beyond quarterly calls, financial statements and recent share price movements. Capital markets are criticised as increasingly short-term, while the investment chain has become more global and complex. The landscape of financial risks has correspondingly evolved. Investors must be concerned with financial performance that meets their fiduciary obligations, which typically extend over a long-term time horizon. This has driven a growing focus on material, industry-specific ESG performance and systemic risk indicators, as well as on the need for liquidity, to meet both current and future funding obligations to ultimate beneficiaries.

The concepts of guardianship and trust lie at the heart of fiduciary duty. The fiduciary relationship between those to whom power is entrusted to invest (the "investor fiduciaries") and the fund beneficiaries sets the stage for developing stewardship policies and practices. Asset owners have fiduciary obligations to their end beneficiaries. Fiduciary duties exist to safeguard the current and future interests of fund beneficiaries, both to enhance value and to protect them from potential misuse of their assets, owing to negligence, conflicts of interest (or agency issues) and/or incompetence of their investor fiduciaries.

It is vital that the investor fiduciary adopts stewardship practices which allow it to effectively discharge its fiduciary duty over appropriate time horizons. Investors are stewards of an ever-growing percentage of global investible assets. The rapid institutionalisation of savings has increased with corresponding systemic effects. As markets have become more complex and investors' asset allocations have become increasingly global and diversified, the investment service provider sector has also grown.

Correspondingly, nearly all markets have legal mechanisms in place to protect fund beneficiaries from harm at the hands of third party agents. Most investor fiduciaries outsource or contract with multiple external managers, advisors and consultants to gain expert advice and broader exposure to markets, asset classes or industry sectors. This highlights the importance of alignment between the investor fiduciary's governance practices and its fundamental fiduciary obligations.

This Guidance on Investor Fiduciary Duties complements, and builds from, ICGN's Global Stewardship Principles[2], first published in 2003 and revised in 2016, as well as the ICGN Model Mandate (2014)[3] and the Global Governance Principles (2015)[4]. The Guidance has been developed by the ICGN Shareholder Responsibilities Committee in consultation with ICGN Members and offers an investor perspective of how fiduciary duties and responsibilities take shape when applied to the management of financial assets.

The Guidance highlights the importance of maintaining consistency between investors' stewardship practices and investors' fiduciary responsibilities. While standards of implementation for investor fiduciary duties vary across markets and legal environments, and over the course of time, the fundamental fiduciary principles which underpin those standards should remain consistent. Investor fiduciaries who serve as investment managers have, by definition, been assigned authority to manage funds on behalf of asset owners.

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Fundamental investor fiduciary duties

Investor fiduciaries hold a unique position of trust, requiring strict standards of conduct. The word "fiduciary" originates from the Latin word, "fiducia," which connotes a relationship of trust, confidence, and reliance. As such, the reference to "fiduciary duties" in this Guidance refers to core procedural and behavioural tenets that a fiduciary entity is expected to uphold as it acts to protect and steward assets on behalf of current and future beneficiaries.[5]

While terminology, legal constructs and behavioural interpretations may vary between entities, across jurisdictions, and over the course of time, the overarching fiduciary principles relevant to sustainable investment practices remain relatively constant.[6]

There are two central principles which typically form the core of fiduciary duties:

- **Duty of Care / Prudence**, which is intended to protect beneficiaries from negligence and incompetence of their investor fiduciaries. The word "prudence" is derived from the Latin "prudentia," which means use of forward-looking wisdom and discretion that is cautious and careful:
- **Duty of Loyalty**, which requires investor fiduciaries to serve the interests of beneficiaries first and foremost, in order to guard against personal bias, misuse and self-dealing by the fiduciary.

This Guidance seeks to expand on the above two central duties by defining further fundamental global principles of fiduciary duty this includes and extends beyond an ESG focus and is distinct from specific, legal jurisdictional frameworks that apply to each institution.

The following principles are not intended to be prescriptive or exhaustive, and aim to help guide investor fiduciaries in their understanding of how to apply fundamental investor fiduciary duties regardless of jurisdiction, law, regulation or custom.[7]

- **Precautionary 'do no harm' duty** recognises the dependence of beneficiaries on their investor fiduciaries and that investor fiduciaries may, intentionally or inadvertently, cause harm to those they are entrusted to protect. This also relates to the concept of 'social contract' and legitimacy which infers the need to inform investment decisions so as to avoid or minimize negative environmental or social impacts, with potentially adverse consequences for beneficiaries.

- **Duty of impartiality** recognises that different classes or types of beneficiaries may have interests which conflict or diverge from each other. The duty of impartiality is core to the concept of sustainable value creation, as it recognises varying generational time horizons, investment risk tolerances and long-term capital growth expectations. It contemplates an obligation to identify, consider and attempt to balance competing beneficiary interests, while recognising that absolute impartiality between generations of beneficiaries may not always be possible.
- **Duty to maintain adequate diversification at the total fund level** is an aspect of prudence. Diversification across asset classes and global markets may spread investment risk to keep it within acceptable limits. Diversification is not mandated when it is considered imprudent to diversify. This duty should not be misconstrued as a mandate to over-diversify or broadly hold all assets in a selected performance benchmark.
- **Duty to incur only reasonable costs to achieve investment objectives** so that fund assets are not wasted on excessive or needless expenses. This duty is not framed as an obligation always to take the lowest cost option, rather, the primary focus should be on net performance after fees, while achieving a reasonable rate of return within an acceptable level of risk.
- **Duty to inform and consult with beneficiaries, clients and other stakeholders** to foster accountability and earn their confidence. Investor fiduciaries should properly inform, confer with and report to their beneficiaries' or clients' in order to achieve accountability and ensure the fund is invested according to their beneficiaries or clients interests as expressed in the statement of investment policy.
- **Duty to comply with governing documents** recognises the duty to ensure that all contractual, statutory and other legal obligations are sufficiently met to minimize the threat of any legal challenges and related expenses. Investor fiduciaries should ensure that their governing documents are fit for purpose they should commit to standards reflected in stewardship codes and relevant regulation.

The application of the above fiduciary duties is a dynamic process and their interpretation and implementation change as circumstances, knowledge and societal norms for reasonable behaviour evolve. Fiduciary duties are principles-based and process-oriented, rather than prescriptive rules, and are therefore applied differently by different entities. Varying fund circumstances (such as legal constraints, funding status, societal norms, risk tolerance, participant base and payout obligations) influence fiduciary decisions. Even when a similar fiduciary approach is used, the ensuing strategy, decisions and end results will vary.

Governance responsibilities for investor fiduciaries

Asset owners, as investor fiduciaries, cannot discharge their fiduciary obligations simply by hiring an asset manager. They may delegate investment tasks to asset managers, who themselves have a fiduciary duty to their client, but fiduciary duty itself is a core governance concept that cannot be delegated by the asset owner. Navigating the asset owner and asset manager relationship appropriately to maintain healthy, two-way communication between informed parties is a core governance responsibility for investor fiduciaries. A complicating factor is that the investment chain includes intermediaries who may not owe any fiduciary duty to the asset owner.

Asset owners and asset managers exist to serve the best interests of their beneficiaries or clients. As such, the model of fund governance should clearly take the interests and expectations of beneficiaries and clients into account, and the fiduciary should recognise that it is accountable for its decisions. Without such a model in place, it is quite possible for investor fiduciaries to satisfy narrow legal constructs of fiduciary duty while breaching the principle of trust between the fiduciary and the client/beneficiary.

Stewardship expectations should be clearly articulated in the written mandate between asset owners and asset managers. Periodic evaluation of these terms as set out in the asset manager/asset owner agreements contributes to clarity of expectations and promotes mutual understanding between parties. ICGN's Model Mandate provides a framework and accompanying language to express these expectations[8].

Asset owners should ensure they are appropriately informed and fully understand the implications of their instructions as set out in their statement of investment policies, such as asset allocation, market exposures, investment exclusions and other related investment parameters. These instructions then influence the investment universe, risk-adjusted returns and social impact, including systemic risk impacts.

Asset owners should recognise their accountability to fund beneficiaries. An investor fiduciary cannot act in the best interests of the client or beneficiary without informing the client or beneficiary of the risk-return implications of any investment strategy, and should consult with them periodically for client or beneficiary input. Accountability is actually two-way: the investor fiduciary must report to the client/beneficiary and the client/beneficiary must recognise that any investment parameters they choose may impact investment risk and return.

Investor fiduciaries must consider whether fund assets are invested over an appropriate time horizon to meet current and future liabilities, are appropriately diversified and adequately consider ESG factors. Investor fiduciaries should also consider whether investment strategies are aligned with mitigation of systemic risk, and whether they are conducting appropriate stakeholder relations to inspire client/beneficiary confidence.

Asset owners should undertake close scrutiny of their model of fund governance rather than simply focus on how they implement their fiduciary duty across the investment chain. ICGN principles and policy statements may provide important guidance for both asset owners and asset managers on best practices that can help them effectively fulfill their obligations.

"Investors should keep under review their own governance practices to ensure consistency with the aims of national requirements and the ICGN Global Stewardship Principles and their ability to serve as fiduciary agents for their beneficiaries or clients." Principle 1; ICGN Global Stewardship Principles

Fiduciary duty and systemic risk

The nature of systemic risk is that it builds over time, is interactive and synergistic and, once in play, is difficult to control. Systemic risk drivers tend to be cumulative and/or interdependent, resulting in far-reaching impacts, shocks, or even system-wide failure such as the global financial crisis in 2008. However, systemic risks can also affect investment returns more slowly, eroding economic performance over time in ways less obvious to market-relative benchmarks, for example, in the case of excessive income inequality.

Some of the more significant systemic threats facing the stability of the global financial system include:

- Macro-economic risk, including market and credit risk and changes to political, legal, regulatory and fiscal instruments;
- Environmental risk, including climate change, water scarcity and pollution;
- Social risk, including human rights, income inequality and populism;
- Governance risk, including expropriation of control and corporate culture; and
- Technological risks, including artificial intelligence and cyber-security.

Many of these risks feature prominently in assessments by entities such as World Economic Forum, World Bank, European Central Bank and the Financial Stability Board (FSB) and are considered by investor fiduciaries in their respective risk assessments. Investors are also increasingly reporting on their progress in meeting the United Nations' Sustainable Development Goals, a framework of 17 global goals which address societal risks such as poverty alleviation, gender equality, protection of fragile ecosystems, and encouraging sustainable infrastructure.[9]

Systemic risks can often be neglected. On the one hand, they may be treated as immaterial by many investors with short-term horizons and market-relative benchmarks. On the other hand, they can go unaddressed by long-horizon investors who assume they will be protected through broadly diversified market exposure and the regulatory environment of the day in which political factors are less of a consideration. The ultimate costs of systemic risks are, by definition, undiversifiable and borne by all market participants, as well as by society more broadly. Ensuring that their fund's investment strategy is protected against systemic risk is a concern for investor fiduciaries.

The production of investment returns to meet fund liability obligations, within a prudent level of risk, is the core obligation of investor fiduciaries and it follows that consideration of systemic risk is embedded in fiduciary duty. Investor fiduciaries therefore should take both a fact-based and a longer term holistic view toward balancing how their investment practices affect the short- and long-term interests of their beneficiaries. Over the long-term, unsustainable investment practices that carry material systemic risks or impose negative externalities on society may have adverse financial consequences for beneficiaries.

Mitigating any potential effects from systemic risk may be considered part of fiduciary duty. The investor fiduciary should attempt to reconcile considerations of systemic economic, social and financial stability across the total fund with risk and return objectives and input from various stakeholders' points of view. This may be achieved by considering the following:

- **PESTEL framework:** The majority of systemic investment risks fit into the political, environmental, social, technological, economic and legal (PESTEL) framework for organisational risk management and planning.[10] They include risks such as bribery and corruption, biodiversity loss, income inequality, human rights abuses, cyber-security, technological risks and weak rule of law. Investor fiduciaries should consider the interdependent nature of these risk categories, especially considering the impact of globalization resulting in further compounding of systemic risk exposures over time.
- **Climate change:** Climate change has emerged as one of the most pressing, 'higher order' systemic financial risks considered by the investment community. Related investment risk considerations include: 1) physical weather-related impacts, resulting in property damage, insurance write-downs and interruptions of global business operations; 2) regulatory uncertainty across markets, with respect to countries' efforts to curb carbon emissions and various tax incentives; and 3) increased liability, with resultant reputational risks.

  Accordingly, investor fiduciaries should be aware of the implications that climate change has for asset class risk. For example, for real assets such as real estate and infrastructure, as well as for commodity risk exposures, industry risk exposures, operational risk, country risk exposures, asset life projections, stranded asset risk and heightened volatility of expected returns. The FSB Task Force on Climate Related Financial Disclosure recommends that companies and investors alike disclose how they govern climate risk, their carbon emissions, emissions intensity, and their metrics and targets to decrease emissions over time.[11]
- **Supply chain:** Increasingly complex, interdependent global supply chains may be compromised by various problems, whether emanating from climate-related issues, labour-related issues, or political or regulatory issues, leading to business delays, reduced revenues, higher costs, dissatisfied customers, legal issues, issues of environmental degradation and even human rights abuses - all of which can have financial risk and return implications for long-term investors.
- **Disclosure obligations:** Investor fiduciaries should seek to promote and demonstrate transparency by broadly disclosing their own governance processes. This includes the identification and management of systemic risk factors, such as including a description of how investors assess climate resiliency across portfolios, how they benchmark companies' environmental and social performance across sectors, and the impact of their own corporate culture on how they manage ESG risks and opportunities. A notable example of this is the requirement under French law, Article 173, for asset owners to publicly report on their carbon risks and climate policies.
- **Governance:** Investor fiduciaries should develop a governance framework to oversee management of systemic risk at the highest level and create a strategic plan that deals with systemic risks. This could include markers to identify early warning signals for systemic risk factors, such as over-leverage, excessive myopia, concentration of market liabilities, dysfunctional ESG practices and other potential sources of market contagion.

"Investors should build awareness of long-term systemic threats, including ESG factors, relating to overall economic development, financial market quality and stability and should prioritise the litigation of system-level risk and respect for basic norms over short-term value." Section 6.3; ICGN Global Stewardship Principles

Fiduciary duty and time horizons

A key responsibility for investors with liabilities that are paid out and can extend over decades is the creation of long term, sustainable value. The Brundtland Report defines "sustainable development" as development that meets the needs of the present without compromising the ability of future generations to meet their own needs.[12] The fiduciary duty of impartiality requires that investor fiduciaries with long-term obligations apply similar inter-generational risk management fairness standards.

Investor fiduciaries may have to balance potentially competing interests across different beneficiary groups, particularly when managing assets to cover long-term liabilities with different maturities. This includes balancing any conflicting investment strategy interests for "young" and "old" beneficiaries (e.g., generation of current income versus future capital growth) and invokes the concept of intergenerational equity.

Investor fiduciaries with obligations to different generations should seek to balance cross-generational wealth maximisation and the potential transfer of risks between generations. By their very nature, certain asset owners (e.g. pension funds and insurers) are more likely to have a long-term approach for their investments and this is also reflected in applicable (prudential) regulations. A primary obligation of investor fiduciaries with long-term liabilities is to align investment practices with the creation of long-term, sustainable value, while minimizing risks that could impact future returns.

There are two misalignments at the heart of the sustainability challenge: one concerns the appropriate time horizon; the other concerns the appropriate conception of risk. Certain risks can be considered as more relevant (i.e. more likely to materialise) over the long term. The double compression of time and risk can drive a mismatch of investment objectives. Fiduciaries should clearly understand and manage the trade-offs between short-term value enhancement and long-term economic prosperity. A focus only on short-term performance may result in unintended consequences which can undermine future performance or later emerge as material liabilities.

Investors invest across multiple time horizons, consistent with their investment objectives, policies, and short- and long-term liabilities. However, even investors with shorter term time horizons can benefit from improving the longer term prospects for portfolio companies, which leads to more sustainable business plans, future cash flows and higher current valuations. Investor fiduciaries should consider the unintended consequences of short-termism and its impact on how systemic, environmental, financial and social risks are identified, understood and integrated in the investment process. In doing so:

- Investor fiduciaries with long-term liabilities should adopt investment and risk management policies and practices that promote long-term wealth creation consistent with their financial obligations to ensure long-term sustainable returns and should consider inclusion of investor and corporate short-termism as risks to be addressed in their policies and practices;
- Investor fiduciaries should consider identification and engagement with portfolio companies whose business strategies do not extend through their business cycle, and whose activities or business models are more likely to be subject to structural changes or challenges in the longer term; and
- Investment strategies of long-term investor fiduciaries should include views on managing potential conflicts between short-term investing and engagement activities and practices that serve the long-term goals of investors with long-horizon interests.

The risk of a mismatch between the time horizons used for investments and long-term interests of ultimate beneficiaries increases when the management of assets is delegated to third parties. Contracts with third parties entrusted with the management of fund assets are typically short term and subject to extension or renewal.

The award of (variable) compensation paid to asset managers can also be subject to short-term return on investments. This may create too many incentives for asset managers to focus on short-term performance. When delegating certain tasks, investor fiduciaries must act to preserve the interests of the ultimate beneficiaries.

Investor fiduciaries with long term investment objectives or constraints should ensure that these are (also) properly reflected in the mandates of their asset managers: long-term investment objectives and performance should be properly rewarded and should be considered when evaluating a possible extension or renewal of the asset management contract.

"Investors should recognise that a primary responsibility is to preserve and enhance value which is aligned in the interest of beneficiaries or clients over an appropriate time horizon, which in most cases requires a long-term perspective." Section 1.1; ICGN Global Stewardship Principles

Fiduciary duty and environmental, social and governance factors

Historically, concepts of fiduciary duty have focused on maximising investment returns without due consideration of environmental, social and governance (ESG) factors. However, expectations have changed over time as evidenced as follows:

- Freshfields Report published in 2005 declared it to be an abrogation of fiduciary duty should investor fiduciaries fail to take relevant ESG considerations into account.
- PRI's 2015 report on fiduciary duty in the 21st Century emphasized that not considering long-term investment value drivers in investment practices is a failure of fiduciary duty.
- CFA Institute now includes ESG training in its programming, including ESG risk exposure analysis, resulting implications for valuations, and positive and negative screening.
- ICGN Global Stewardship Principles, first published in 2003, promote long-term value creation and ESG integration as one of seven overarching principles and ICGN has been delivering courses on the subject since 2012.

Today many investors feature specific clauses related to responsible investment and management of ESG factors in their Statements of Investment Policy. ESG factors are increasingly viewed as material to investment risk and return, particularly for long-term investors. Examples of ESG-related risks and opportunities include:

- Environmental factors such as a company's commitment to decreasing emissions or its incorporation of eco-efficiencies;
- Social factors such as the company's record on human rights, product safety and worker safety; and
- Governance factors such as the quality of board leadership, composition (including gender diversity) or executive compensation.

Overarching ESG risks across portfolios include legal and regulatory risk, geopolitical risk and reputational risk, which in turn lead to additional risk layers and outcomes, such as potential stranded-asset risk and systemic risk.

Calls for improved corporate and investor ESG disclosure are being driven by investors, policy makers, regulators and the general public. Investor fiduciaries are attempting to address this demand by hiring more ESG expertise and embedding consideration of ESG across the investment process.

It is now recognised that many investors are 'universal owners' of the global economy as they steward assets that are broadly invested across multiple markets for the long term. This recognition of the economic importance of investor fiduciaries has fostered several country investor stewardship codes that encourage consideration of ESG factors in investment decision-making, including consideration of systemic risk exposures.

Academic evidence

A number of academic studies have helped to illustrate and document the business case for responsible investment and the integration of ESG factors in the investment process. In the event of a choice between investment options with similar return-on-investment characteristics, the option with the better ESG assessment generally provides a lower risk profile over the long term. Similarly, an ESG-tilted portfolio has been demonstrated to offer insurance-like protection, which may result in a higher credit rating and a lower cost of debt.[13]

A meta-study concluded in 2012 identified that the cost of capital is lower for companies with higher ESG scores. Consideration of key ESG metrics can reveal alpha, or abnormal returns that are overlooked by traditional investing strategies. [14] For example, a 2013 research paper concludes that a statistically significant and positive relationship exists between certain corporate governance metrics and company valuation.[15]

A 2015 aggregated meta-study that reviewed around 2,200 empirical studies relating to ESG and corporate financial performance reveals that roughly 90% of studies find a non-negative relation between ESG and corporate financial performance. The large majority of academic studies report positive findings, and concludes that the positive ESG impact on corporate financial performance appears stable over time.[16] Overall, the building weight of academic research across a broad spectrum of ESG factors demonstrates the importance of ESG performance to shareholder value.[17]

This growing body of academic and statistical evidence makes a compelling business case for incorporating analysis of ESG factors into investment decisions and for managing exposure to systemic risks. Improved awareness of various incidents, accidents and corporate malfeasance has contributed to increased demand for responsible investment and consideration of ESG factors among asset owners and their beneficiaries. It also reflects the global community's growing concern about key ESG issues. The lowering of the costs of accessing ESG data should have a possible effect on the use of ESG factors in investment decision-making.

Growing public and media attention to the potentially harmful long-term effects of corporate activity is attracting regulatory responses across the world. This, in turn, has stimulated investor demand for companies to provide better ESG disclosure, including how they mitigate these risks. This is supported by organisations such as the International Integrated Reporting Council, the Sustainable Accounting Standards Board, the Global Reporting Initiative and other members of the Corporate Reporting Dialogue[18] which are focused on improving corporate disclosure of ESG metrics.

With visibility through modern technology, companies and their investors must deal with unprecedented reputational risk, as well as increased regulation and attendant compliance costs. Companies may choose to respond to greater public focus on their corporate culture by, for example, offering reassurance and insights as to how they are managing related ESG factors and the expected impact on firm risk or performance.

Nevertheless, consistent and reliable data on ESG and systemic factors still lags investor demand. Investor fiduciaries should take account of their stewardship responsibilities, including ESG factors and systemic risk exposures, in developing and implementing investment and risk management policies. Considerations outlined in this Guidance regarding delegation of responsibility, oversight of service providers, and use of appropriate investment time horizons, are particularly relevant to stewardship and ESG integration.

Asset owners should ensure that they consider inclusion of responsible investment and consideration of ESG in their statement of policy and procedures/goals, to be reviewed and updated regularly. Policies and practices to be considered by asset owners build from ICGN's Global Stewardship Principles include:

- Ensuring that their investment managers, advisors, consultants and professional staff are fully competent and trained to take ESG into account across investment decision-making and reporting. The CEO and CIO of the investor fiduciary should provide assurance that ESG is adequately reflected in internal processes;
- Development and use of bespoke proxy voting guidelines and corporate governance principles to adequately manage shareholder rights. The investor fiduciary should take care to ensure votes are cast in the interests of beneficiaries or clients and that shareholder voice is appropriately exercised;
- Priorities for company engagements and expectations for reactive, proactive and ongoing ESG company engagements;
- Collaboration with like-minded investors on company engagement initiatives to improve effectiveness, when appropriate;
- Incorporation of ESG factors, engagement results, and systemic risk considerations in strategic plans, guidelines, performance metrics and reporting protocols across all asset classes (including corporate debt), as relevant;
- Active monitoring and evaluation of manager implementation of ESG and systemic risk management strategies;
- Reporting to beneficiaries and stakeholders on investment objectives and policies and their implementation, including on stewardship and ESG integration matters;
- Including the fund's performance on ESG factors in compensation of investment staff. This could include feedback from client satisfaction surveys on the fund's management and integration of ESG principles.

"The term ESG factor is used to mean material and relevant investment risks and opportunities for asset owners with long-term investment horizons. They may have a significant (albeit often difficult to quantify) financial impact over the investment life of the asset owner – though often requiring an intervention to internalise external costs or some other regulatory change before those costs are triggered – and clients are increasingly seeking to build them into the risk management processes and investment decision-making of their managers." Section 1.0; ICGN Model Mandate

Fiduciary duty in the investment chain

Determining who is defined as a fiduciary and under what circumstances is essentially a local law issue. However, fiduciary standards and ICGN principles provide direction for investment industry leaders who seek to follow governance practices that are aligned with fiduciary principles in performing their duties, including their interactions with parties to whom certain tasks have been delegated with respect to the management of fiduciary assets.

Investor fiduciaries are seldom able to perform all of the tasks relating to asset management without relying on outside service providers. The investment service provider chain has grown longer over the past several decades, resulting in greater dispersion of the relationship between the various parties. Fiduciaries may delegate certain tasks to third parties. However, no matter how complex the investment chain, ultimate fiduciary responsibility cannot be delegated from the investor fiduciary to a contracted third party, nor can it be diluted by delegation to third parties.

Investor fiduciaries may be held accountable by fund beneficiaries, even when they choose to hire external managers and service providers to manage a portion of fund assets. This may occur in situations where a fiduciary does not possess the skills, market presence, expertise, resources or capacity to perform a desired task; however, the responsibility for the selection, instruction and oversight of any third-party delegates (outside investment advisors, managers, consultants and other service providers) remains with the investor. It remains a critical fiduciary function.

Investor fiduciaries should be attentive to aligning beneficiaries' interests with the interests of any third-party agents given authority to control a portion of fund assets. Accordingly, when hiring external third parties, the investment fiduciary should address pertinent issues during the selection process, incorporate these in the investment management agreements, and subject them to ongoing monitoring and reporting protocols.

In their selection processes for competent third party external managers the investor fiduciary should consider whether:

- The third-party managers under consideration can be held to the same standards as the asset owner/manager, whether via operation of the law or by contract. The duties owed to beneficiaries should not be diluted or diminished by delegation. In some instances, beneficiary interests might need to be explicitly identified when a selected provider is not otherwise cognizant of them;

- The agreed investment and risk management policies and processes include objectives with respect to time horizons, risk tolerances, stewardship responsibilities and ESG considerations, including in proxy voting and in company engagements, and how responsible investment activities will be reported to the investment fiduciary. Metrics used for monitoring investment portfolios should seek to balance short- and long-term performance indicators and include systemic risk, stewardship and ESG measures. For investors with long-term liabilities, oversight should be focused accordingly, without overemphasizing results that are immaterial to meeting longer-term obligations;
- Decisions requiring approval or meriting notification to the investor fiduciary are appropriately specified, including circumstances allowing a revocation of the delegation.

In addition, in its monitoring and evaluation processes the investor fiduciary should consider:

- Whether sufficient attention has been given to emerging trends regarding the potential imposition of regulatory standards across the investment service provider chain (e.g., proxy advisories, ratings agencies, carbon foot-printing services);
- Whether it has sufficient transparency to command a clear view of all parties involved in the investment chain. The delegation and sub-delegation of investment or management tasks should not reduce the flow of material information to the investment fiduciary nor compromise its ability to exercise risk management, monitoring and investment responsibilities;
- Whether consistent provisions have been incorporated into service provider selection processes, contracts, guidelines and reporting protocols throughout the service provider chain, with attention given to authorised sub-delegations and investment counterparties. Asset owners should seek to avoid any breaks in the chain of fiduciary responsibility and stewardship;
- Compensation and remuneration paid to third parties contracted or employed by the investment fiduciary should be aligned with beneficiaries' interests. They should include appropriate incentives for the services providers to act in accordance with the principles and objectives set by the investment fiduciary, including with regard to ESG and stewardship matters;
- Consideration should be given to whether a fiduciary can avoid contracting with third parties that seek to avoid an appropriate level of financial responsibility for their services.

Investor fiduciaries should retain full oversight of situations where different service providers take conflicting actions or decisions regarding management of the same assets. To the extent practicable, investor fiduciaries should prioritise reporting, disclosure, communication and coordination throughout the investment service provider chain in order to identify any situations where different managers or advisors may end up working at cross-purposes to the detriment of the overall fund, and subsequently direct actions to most consistently benefit the fund.

"Asset owners are increasingly considering how they can more fully align the interests of their fund managers with their own obligations to beneficiaries and participants." Preamble, ICGN Model Mandate

Reporting and accountability

Fiduciary relationships involve a contract that requires trust between beneficiaries and the agents who control management of their assets and represent their interests. Effective two-way communication is essential to maintaining trust and informing the fiduciary's efforts to serve beneficiaries' interests. Accordingly, an investment fiduciary has a duty to inform and regularly engage with its beneficiaries/clients. Most investor fiduciaries are already subject to regulatory or contractual reporting obligations designed to keep beneficiaries and other stakeholders informed about matters that are relevant to performance of obligations.

Subject to mandatory reporting obligations which may be more specific or have a wider scope, investor fiduciaries should regularly report how their investment principles, objectives and activities address systemic risk and contribute to financial market stability and how they take into consideration the appropriate time horizons as well as ESG factors. Investor fiduciaries should also explain and justify how actual investments of assets and related stewardship activities are consistent with the stated investment principles and objectives. Many investors are beginning to report on the UN Sustainable Development Goals, which were adopted by the UN as a template to address salient global issues, with implications for policy makers, companies and investors.

Delegation to third parties should be addressed. These agents must be subject to mutually agreed reporting obligations, consistent with the objectives of the investor fiduciary. The investor fiduciary should further require assurance of the quality of the reporting, which can be used in their communications with beneficiaries, together with a description of how the delegation of tasks to third parties is consistent with the interests of beneficiaries.

Robust stakeholder relations should be a priority for investors. From a practical perspective, an effective stakeholder communications plan can avoid unnecessary problems and reduce liability exposure. Information and transparency about how investors discharge their duties serves to inform clients and helps them to hold investor fiduciaries to account.

Investor fiduciaries should adopt and maintain the appropriate internal governance structures, policies and protocols to facilitate the process of seeking and receiving regular input and feedback from client/beneficiaries and, where possible, address and seek to align various client/beneficiary preferences in the investment process.

Investor fiduciaries should facilitate an ongoing dialogue with their clients and/or beneficiaries. Clients/beneficiaries should be given the opportunity to express their opinion about investment objectives and principles, including on issues addressed in this Guidance. Investor fiduciaries should also take the initiative to consult with their beneficiaries whenever they want to review those objectives or principles. All clients, beneficiaries and key stakeholders should be treated equitably, including in the situation of a multi-client or multi-stakeholder relationship.

In approaching reporting and stakeholder communications obligations, investor fiduciaries should review best practices of peers and develop their own stakeholder relations plan aimed at preserving a high level of trust while meeting reporting requirements. Investor fiduciaries should also explore ESG and systemic factors reporting across portfolios and encourage investee companies to integrate ESG reporting into their financial reporting.

Serving as an investor fiduciary is a demanding role that imposes high standards of conduct and requires close attention to evolving industry practices. Robust communication protocols lie at the heart of managing the fiduciary-investment manager relationship. The investor fiduciary has a duty to inform and educate its client beneficiaries without unduly influencing them; while it is important that the asset owner remains sufficiently informed to understand the investment consequences of its investment policies for asset allocation, risk tolerances and exclusions.

The fact that the investment chain has become increasingly complex does not 'water down' fiduciary duty responsibility or its core underpinning principles of trust and stewardship. The investment manager that manages multiple external manager and fund relationships must be diligent to ensure that various investment strategies align with its overarching fiduciary obligation principles.

Today there is a widespread acknowledgement that ESG factors contribute to financial risk and performance as well as systemic risk. Investor fiduciaries must focus on aligning their governance and practices with beneficiary interests in respect of these factors. The ICGN Model Mandate provides a summary of how to incorporate a modern understanding of fiduciary principles into the governance practices of investor fiduciaries.

Key areas of focus for asset owners who are seeking to align the activities of their fund managers more closely with the long-term interests of their beneficiaries are described in the preamble of the ICGN Model Mandate as follows:

- Ensuring that the timescales over which investment risk and opportunity are considered match those of the client;
- Setting out an appropriate internal risk management framework so that the risks which matter for clients are managed effectively;
- Effectively integrating relevant environmental, social and governance factors into investment decision-making and ongoing management;
- Aligning interests effectively through fees, pay structures and culture;
- Where engagement is delegated to the fund manager, ensuring, adherence to the highest standards of stewardship;
- Ensuring commission processes and payments which reward appropriate research;
- Ensuring that portfolio turnover is appropriate to the mandate, in line with expectations and managed effectively; and
- Providing appropriate transparency such that clients can gain confidence about all these issues.

"Investors should publicly disclose their stewardship policies and activities and report to beneficiaries or clients on how they have been implemented so as to be fully accountable for the effective delivery of their duties." Principle 7; ICGN Global Stewardship Principles

Annex 1: About ICGN Principles and Guidance

ICGN is regarded as a primary source of global investor opinion as outlined in the ICGN Global Governance Principles and ICGN Global Stewardship Principles ICGN Principles are supplemented by ICGN Guidance on a range of themes which are issued periodically to elaborate on key concepts and practices.

ICGN Guidance provides a resource for investor fiduciaries, investment managers and interested parties. They provide insights into leading corporate governance and investor practices that are aligned with fiduciary duties and can help investor fiduciaries fulfill obligations to the beneficiaries and stakeholders who rely upon them.

ICGN Principles:

ICGN Global Governance Principles (2017)

ICGN Global Stewardship Principles (2016)

ICGN Guidance:

ICGN Guidance on Political Lobbying and Donations (2017)

ICGN Guidance on Securities Lending (2016)

ICGN Guidance on Executive Remuneration (2016)

ICGN Guidance on Diversity on Boards (2016)

ICGN Guidance on Non-executive Director Remuneration (2016)

ICGN Guidance on Integrated Business Reporting (2015)

ICGN Guidance on Corporate Risk Oversight (2015)

ICGN Guidance on Anti-corruption Practices (2015)

ICGN Model Mandate: example contractual terms between asset owners and managers (2012)

Annex 2: Acknowledgements

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(Endnotes)

1 See the European Commission Action Plan for Financing Sustainable Growth (March 2018) at http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018DC0097&from=EN and Rory Sullivan, Will Martindale, Elodie Feller and Anna Bordon, Fiduciary Duty in the 21st Century (September 2015) at http://www.unepfi.org/fileadmin/documents/fiduciary_duty_21st_century.pdf.

2 ICGN Global Stewardship Principles: http://icgn.flpbks.com/icgn-global-stewardship-principles.

3 See ICGN Model Mandate: http://icgn.flpbks.com/icgn_model-contract-terms_2015.

4 See ICGN Global Governance Principles: http://icgn.flpbks.com/icgn-global-governance-principles-2017.

5 The RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 227 (1992) provides an overview of common law fiduciary duty for investor fiduciaries. Civil law markets typically use similar statutory or regulatory provisions which identify investor duties and responsibilities that address the same underlying dynamics of institutional asset owner and investment manager obligations to fund participants. See Keith L. Johnson, Introduction to Institutional Investor Fiduciary Duties, International Institute for Sustainable Development (February 2014), at https://www.iisd.org/library/introduction-institutional-investor-fiduciary-duties.

6 The PRI has a work programme that has developed a number of resources covering fiduciary duty and investor duties and responsibilities across a range of common and civil law jurisdictions, with a main focus on the link between ESG related factors and fiduciary duty. See https://www.unpri.org/sustainable-markets/sustainable-financial-system/fiduciary-duty.

7 The listed investor fiduciary duties and responsibilities may not apply fully in all jurisdictions and might be identified differently under local law. This high-level summary was compiled with assistance of legal counsel from numerous resources, including the Restatement (3rd) of Trusts: Prudent Investor Rule § 227 (1992) and Restatement (Second) of Trusts: Impartiality § 183 (1995); UK Law Commission: Fiduciary Duties of Investment Intermediaries (2014) at http://www.lawcom.gov.uk/app/uploads/2015/03/lc350_fiduciary_duties.pdf; Sullivan, Martindale, Feller and Bordon, Fiduciary Duty in the 21st Century, (September 2015) at http://www.unepfi.org/fileadmin/documents/fiduciary_duty_21st_century.pdf; High Legal Expert Group, on Sustainable Finance, Financing a Sustainable European Economy (February 2018) at https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report_en.pdf; Waitzer and Sarro, "The Public Fiduciary: Emerging Themes in Canadian Fiduciary Law for Pension Trustees" (2013) at http://digitalcommons.osgoode.yorku.ca/clpe/271/; Johnson, Introduction to Institutional Investor Fiduciary Duties, International Institute for Sustainable Development (February 2014), at https://www.iisd.org/library/introduction-institutional-investor-fiduciary-duties; Employee Retirement Income Security Act, 29 U.S. Code § 1104 - Fiduciary Duties, at https://www.law.cornell.edu/uscode/text/29/1104; and Gary, Best Interests in the Long Term: Fiduciary Duties and ESG Integration (February 2018) at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3149856.

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16 Gunnar Friede, Timo Busch and Alexander Bassen, ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies (October 22, 2015). Journal of Sustainable Finance & Investment, Volume 5, Issue 4, p. 210-233, 2015: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2699610.

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18 See Corporate Reporting Dialogue: http://corporatereportingdialogue.com.

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