The impact of recent changes in fiduciary law and obligations to allow trustees to invest

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Thank you for having me. It's a great honour to be here speaking to such an esteemed audience, who have such an important role to play in shaping our future.

I work for ClientEarth, an environmental law charity with over 100 staff based in Europe but working globally.

We don't have any fee-paying clients, instead we use our legal expertise, fine-tuned in the world's largest law firms and best universities, to devise solutions to the world's biggest environmental challenges.

Something ClientEarth does differently to most public interest law firms is that we also have a corporate law division, which I lead.

Our rather dully named 'Company and Financial Project' has an exciting aim.

Essentially, we're getting people who should be talking to each other, but who don't, to have conversations about their role in saving the planet.

In that way it's very similar to today's meeting – about finding common understanding on a shared goal – the shared goal of our survival, which means we have to think in systems that involve not only each other but the operating system we all share – the environment.

As Gaylord Nelson, American Senator and the inventor of Earth Day once observed 'The economy is a wholly owned subsidiary of the environment not the other way around'.

And yet how is it that a global development charity on the frontline of climate change is investing its money in a passive index, heavily weighted to fossil fuels?

How is it that at a meeting of the senior management of one of the world's biggest insurance companies that I attended earlier in the year hardly anyone in the audience knew about the Paris Agreement? I'm not joking.

Finance thinks narrowly, business thinks narrowly, governments think, too often, narrowly (sometimes as a result of the aggressive lobbying of finance and business to do so) – and the result is a tragedy for all.

So we use the law to bring companies, asset owners, asset managers, and professional advisers within the financial sector, including lawyers and accountants, together to have the conversations that matter about how we collaborate.

Today's conversation is about fiduciary duty and climate change.

It is the highest standard of care known to law. It is a remarkable legal duty because it applies in broad terms across the world.

Historically it has been a *barrier* to having the conversations we should be having.

I am here today to let you know that the law is no longer a barrier.

In fact, it now *requires* the person in charge of the money to talk to the person in charge of sustainability.

At its core, fiduciary duty requires a person entrusted with care of money to act prudently and in the best interests of the beneficiary.

In the case of a pension fund trustee, the 'best interests' of the beneficiary is usually the best 'financial' interests.

For faith investors, the duty is wider. But we'll start with the narrow definition.

In making investment decisions, a fiduciary must ***assess*** and ***manage*** financial risks to the portfolio – taking into account all relevant factors, balancing risk against return.

Fortunately, that well known environmental NGO the Bank of England has given us a good summary of the 'relevant factors' for climate related financial risks. It identified 3 categories:

1. Physical risks
2. Transition risks; and
3. Liability risks

Physical risks include rising sea levels, ocean acidification, extreme weather events, including flooding, bushfires and hurricanes.

As Johan Rockstrom of the Stockholm Resilience Centre said, “You may have noticed the environment is starting to send back invoices”. Invoices like the destruction of the Caribbean, New Orleans, or vast tracts of Californian and Australian farmland turning to ash.

These events create serious business risks – disruption in supply chains, production of food, damage to property and infrastructure.

Transition risks are a result of global energy supply moving from fossil fuels to renewables thanks to the growth of wind and solar and technologies that encourage electrification (such as electric vehicles), and increasing climate related regulations which impose costs on carbon intensive sectors. The Paris Agreement is the ‘big daddy’ of these – it crystallises transition risk.

The Bank of England warned that these risks could prompt a reassessment of the value of a large range of assets – particularly fossil fuel companies – also known as ‘stranded assets’.

Liability risks are the consequences of failing to manage the physical and transition risks to a particular company or investment portfolio. For example, directors of fossil fuel companies may be the subject of law suits in the future if statements about the strength of their business models are found to be misleading.

Taken together, these are the financial risks of climate change, and managing these risks fits squarely within the narrowest definition of your existing fiduciary duty.

So it’s not the law that has changed, it’s the nature of climate change. It has evolved from an ethical issue, to a financial one. One of the great ironies is that our collective delay in dealing with climate change means we now must, or risk being sued.

This means at a minimum, you should have undertaken a climate risk assessment, sought expert advice from appropriately qualified advisors, updated your investment strategy, and reviewed your asset allocation and your manager selections.

You *certainly* should have had that conversation with your sustainability colleagues.

A thornier question is what does the law say about Step 2 – how should investors manage the financial risks of climate change?

Well, the good news is that the courts grant investors a large amount of investment discretion at this stage.

As long as you have acted reasonably and taken account of all relevant then your decisions are unlikely to be susceptible to challenge.

The bad news is this is not a 'get out of jail free' card, particularly for faith and charity investors who are legally permitted to apply a broader definition of fiduciary duty to investment decisions, and therefore are expected to.

Faith investors can decide to invest ethically, even if the investment might provide a lower rate of return than an alternative investment.

In fact, if a certain type of investment might conflict directly with the objects/purposes of a faith, the law says the investment must be ruled out "regardless of financial consequences".

In other words, a faith investor is duty-bound to avoid a particular investment that conflicts with its charitable aims.

It is your job to determine how you manage this risk, you are the experts. But here are some questions to help you navigate your legal duties:

1. Do you have the right processes in place to stay on top of the fast-moving evidence?

For example, a recent survey of 25 largest asset managers in the UK found that they consider climate risks will significantly impact the valuations of oil and gas majors in the next 3-5 years. That is within court limitation periods - so decisions being made now may be the subject of litigation in the future.

2. Have you stepped back from the issue because you have delegated to investment managers?

Don't. Yes, they are the experts, but your job is not done. Global investment consultants Mercer, the Bank of England and others have warned that climate change arises across asset classes, and industry sectors. It is a strategic portfolio risk, which means it is a *non-delegable* duty.

3. Have you chosen engagement as your strategy to manage climate risk?

If so, properly document why you have done so in your meeting minutes. Make it clear you have done so despite reviewing and assessing all of the evidence about the financial risks of fossil fuel stocks.

Make sure your engagement strategy is SMART (specific, measurable, achievable, relevant, time bound). And stick by it. If Exxon management continues to down play climate risk and fund climate denying trade associations get out, please.

Are you holding the minimum you need to engage? Faith groups hold sway without large holdings. Minimise your financial risk while you engage.

Any investment that doesn't consider its impact on the environment isn't an investment in any useful sense. It is simply a cost that we'll have to pay in the future.

As the financial arm of religions who have all taught us to take seriously our stewardship of our common home, you occupy a unique and powerful position.

It's time to have the conversations that matter. The law permits you to, indeed requires you to. And never has your voice been needed more.

Thank you