SUSTAINABLE STRATEGIES

FEEL THE HEAT

Pressure is mounting on the financial services sector to look to its own ESG practices, even without federal impetus

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As I write this the Department of Labor (DOL)'s fiduciary rule is once again in limbo. While some parts of it have come into force, it could yet be revised, rescinded or shoved further back on the shelf.

But while the feds fiddle, Rome does not burn. States are taking it upon themselves to act, and Nevada Senate Bill 383 was signed into law earlier this month to address many of the same issues regarding fiduciary duty and compensated advice.

Financial services companies from banks and broker-dealers to asset managers are powerful aggregators of investor interests. As environmental, social and governance (ESG) demand has grown, firms are stepping up to challenges such as the UN Principles for Responsible Investment (PRI) and becoming levers for change on issues from climate change to indigenous rights.

But what happens when the societal or ethical issue is in our own kitchen?

Prior bad acts, from predatory lending and price fixing to tax evasion and improper account opening, have been exposed and punished by regulators, customers, shareholders and markets. These acts are objectively wrong and in several cases illegal. The fiduciary rule is trickier though, particularly if it does not become the law of the land. It is to financial services what mitigating overseas sweatshop labor is to apparel or what Fair Trade is to food – a best practice but not yet a requirement. Societally and ethically, accepting a level of fiduciary responsibility for the financial services for which a professional or firm has been compensated is not necessarily required by law, but it is best practice and is expected and even assumed by consumers.

THE LAW OF THE MARKET

Regulators and self-regulatory organizations will not always be there to watch over us, and the debate rages on about whether or not they should be and whether their weighty presence stifles commerce and the flow of capital. As with so many other ESG issues, the market itself can be the mechanism for holding companies to account, uncovering and pricing risk, and allocating capital according to merit. The challenge in the case of the fiduciary rule is that the stakeholders who ordinarily engage with and shape the market issue by issue would almost universally be subject to at least some aspects of the rule. With recognition and implementation of the rule comes, in some cases, profound changes in business practices and operations, policies and procedures, company pricing, and even whole lines of business.

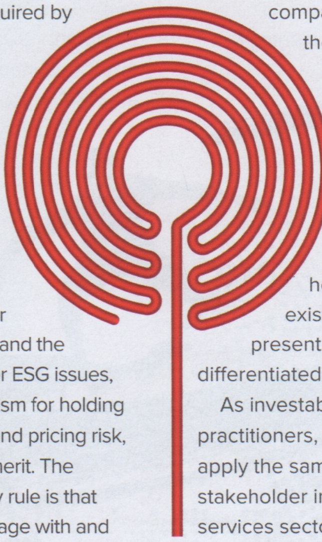
Whether a fiduciary standard is the province of the industry itself, the states, the DOL or the Securities and Exchange Commission, from an ESG perspective the fundamental idea behind such a standard is meritorious. Individuals and companies receiving compensation for financial services ought to have interests aligned with their customers. From a governance point of view a heightened standard of care and transparency would certainly be a positive.

GET YOUR HOUSE IN ORDER

Customers are critical stakeholders in the sustainability of any company. There should be vigorous discussion and debate among ESG investors – with other financial services firms, with regulators and with the community of customers – about how to address a fiduciary standard in keeping with the UN PRI.

Adverse and unintended customer outcomes should be identified and managed, and all stakeholder interests should be considered, including the financial services companies who are entitled to accept appropriate and proportionate risks and be compensated fairly for them.

A wealth or asset manager who declares a commitment to ESG and the UN PRI should be prepared to look at their own business practices and the practices of similar companies in which they invest and then commit to holding them to similar levels of accountability, fairness and transparency as any company in any other industry. A marketplace in which no company did more than what the law required and in which every company lobbied heavily to remove or eviscerate existing laws and regulations would present very few opportunities for differentiated ESG investment.



As investable businesses and as practitioners, it is time to comprehensively apply the same ESG framework for aligning stakeholder interests to the financial services sector.