IN ESG WE TRUST

THE DOL'S BOTCHED STATEMENT ON FIDUCIARY RESPONSIBILITY DELAYED ESG PROGRESS, BUT THE UPDATED BULLETIN CLEARS THE WAY FOR A NEW GENERATION OF RESPONSIBLE INVESTORS

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Is a sense of duty to take environmental, social and governance (ESG) factors into consideration when deploying investable capital ever at odds with fiduciary responsibilities?

Whether rooted in personal values, an institutional mission or the conviction that ESG factors can contribute to investment performance, ESG is now part of the market firmament. How then to reconcile investing with purpose with traditional fiduciary duty?

Charitable organizations have core not-for-profit missions. Those missions could be alleviating poverty, preserving wild places or advancing the fine arts.

Historically, to the extent they had assets that required long-term investment and oversight, the objective of those investments was to maximize return at an appropriate level of risk in order to further the mission of each organization. Investment officers and investment committees understood this to be their sole purpose: guarding and growing those assets.

Rarely if ever was thought given to how those assets were invested as they related to the mission and purpose for which those assets existed in the first place. The organization's impact was achieved and measured through their grants and good deeds funded by that asset pool.

Obtaining better investment outcomes expressed in percentage terms directly and indirectly fed that impact. To consider factors other than risk, return and liquidity was perceived as a breach of responsibility to the organization's mission.

But have you, in a fiduciary capacity, truly maximized the potential impact of the organization if the investments themselves conflict with the mission?

If your charity is addressing the individual and societal consequences of alcohol dependency and your portfolio is invested in spirits companies, have you left that last increment of potential impact on the table?

If your charity is working to preserve coastal wetlands that are essential to hold back sea-rise from climate change, and the portfolio is built on high yield debt issued by explorers and drillers and the stock of integrated oil companies, is the organization providing capital to enterprises that are accelerating exactly what they are trying to hold at bay?

MORAL CONSISTENCY

Religious institutions were among the first to understand this decades ago, notably the Quakers, who appreciated the risks of inconsistency with core values such as pacifism.

Today, the F.B. Heron Foundation has been among the most innovative voices in definitively reconciling portfolio and purpose.

In its own words: 'We removed the division between the investing and the giving operations (traditional in virtually all private foundations), creating a "team of the whole" to deploy all of Heron's capital in concert for mission.' It has also championed this integrated approach to fiduciary responsibility across the foundation and endowment community, helping to illuminate the path for more institutions to embrace ESG and impact.

According to the Investment Company Institute, half to three-quarters of individual investors' first exposure to investing in mutual funds is through a company-sponsored defined contribution retirement plan.

As the demographics of the workforce evolve (more millennials) and companies look for innovative ways to attract and retain talent, sustainable investment options are being seen as a useful means to allow employees to express themselves through their retirement savings, and even to encourage more people to start participating in the first place.

DOL GETS IT WRONG

Unfortunately, a ham-fisted interpretive bulletin from the Department of Labor (DOL) in 2008 threw a fiduciary wet blanket on the willingness of Employee Retirement Income Security Act (Erisa) plan sponsors to look seriously at ESG investment options.

It said: 'Erisa's plain text thus establishes a clear rule that in the course of discharging their duties, fiduciaries may never subordinate the economic interests of the plan [participants and beneficiaries] to unrelated objectives.'

It was not until 2015 that the DOL retraced its steps, and in a subsequent interpretive bulletin undid the damage. The 2015 update clarified that 'it has been the department's consistent view that sections 403 and 404 of Erisa do not permit fiduciaries to sacrifice the economic interests of plan participants in receiving their promised benefits in order to promote collateral goals.'

Setting aside the debunked mythology of underperformance in ESG for the moment, this had erected a barrier to non-economic considerations such as sustainability and impact, especially if there was a perceived financial trade-off.

The DOL effectively erased the barrier by, among other things, now stating: 'fiduciaries need not treat commercially reasonable investments as inherently suspect or in need of special scrutiny merely because they take into consideration environmental, social, or other such factors.'

The fiduciary playing field is now level. If ESG-compliant investment options are otherwise 'commercially reasonable' then there is no heightened responsibility.