Discussing the Relationship Between Fiduciary Duty and Sustainable Investment: An Analysis Based on the UK Legal Context and Factors Affecting Sustainable Investment

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Abstract
Sustainable finance is an important topic in sustainable development, and sustainable investment is one of the means to achieve it. This paper will discuss how fiduciary duties require and limit sustainable investment in the context of the UK legal framework.

Keywords: law and sustainable finance, fiduciary duty, sustainable investment

1. Introduction
Fiduciary duty, the legal obligation to act in the best interests of beneficiaries, plays a pivotal role in shaping investment decisions1. In the context of sustainable investment, this duty both necessitates and limits such endeavours. This discussion will pay particular attention to how UK law and sustainability affect the investment decision-making landscape, and based on this, discuss how fiduciary duties require as well as limit sustainable investment.

2. Analysis
2.1 Fiduciary Duty Requires Sustainable Investment
There are two forms of fiduciary duty that can control ESG and CSR, namely corporate fiduciary duty and intermediary fiduciary duty.2

2.1.1 Corporate Fiduciary Duty
Corporate fiduciary duty refers to a director’s duty to the company3, which means that in corporate fiduciary duty, the director has a statutory obligation to ensure that the company’s property is properly managed and that the company’s interests are maximized.

A key point in the discussion of how corporate fiduciary duty requires sustainable investment is whether and how interests other than those of shareholders are considered in board decisions4.

The modern economic model originated in a period of resource abundance, and as a result, environmental issues were not considered in the design of the economic model, which only pursued the maximization of short-term

market benefits\textsuperscript{1}. In such a context, modern economic development has brought about a series of environmental and social problems. The concept of ESG emerged in the 1970s, and in 2006 the United Nations launched the Principles for Responsible Investment (PRI) aimed at integrating environmental, social and governance considerations into investment decisions and shareholder activities, and in the same year the UK Companies Act (2006) was enacted. The Companies Act 2006 emphasizes the interests of the company, including consideration of the long-term success of the company in relation to its stakeholders, and provides a statutory basis for the consideration of sustainability factors. Of note is section 172 of the Act, which introduces the Enlightened Value Shareholder model\textsuperscript{2}, which requires directors of a company to consider the likely long-term consequences of decisions, focus on the interests of stakeholders, etc., when acting in a way that is most likely to promote the success of the company for the benefit of its members\textsuperscript{3}. This section explicitly requires company directors to consider ESG factors when making decisions. However, although this article is hard law, it cannot be fully binding on the company’s decision-making in the way that hard law can be\textsuperscript{4}. This shortcoming is remedied in section 416 of the Act in relation to disclosure obligations\textsuperscript{5}. For example, the Secretary of State made regulations by 6 April 2012 requiring companies’ directors’ reports to contain information on greenhouse gas emissions from activities for which the company is responsible, or to submit an explanation to Parliament.

2.1.2 Intermediary Fiduciary Duty

Based on the general principle that the content of fiduciary duties can be contractually adjusted; investment guidelines can modify the default model of fiduciary duties held by asset managers to underlying investors\textsuperscript{6}. Building on this theory, the rise of the impact investing model has begun to demand that the obligations of trustees in intermediary fiduciary duties shift from simply making financial profits to focusing on sustainable investing. Impact investing is used to describe investments that are primarily designed to create tangible social impact but also have the potential to generate a financial return on the investment\textsuperscript{7}. As awareness of ESG factors has increased, investors have begun to incorporate this shoehorning into their investment decisions, a behaviour that helps investors to assess the performance of a business more holistically from an ESG perspective.

In his comments on the passage of the Pensions Act 2008, Mr. McKenzie MP said that it was not just a right or a choice, but a duty, for the trustees of a pension fund to state in the Statement of Investment Principles the fund’s guidelines for responsible investment, but also the extent to which the fund takes account of social, environmental, or ethical considerations\textsuperscript{8}. In addition, the UK Corporate Governance Code 2018 requires companies to disclose more ESG-related matters. This suggests that it has become an obligation for trustees in the UK to focus on sustainable investment when making investment decisions and that developments in UK law are helping trustees to take ESG factors into account when making investment decisions.

2.2 Fiduciary Duty to Limit Sustainable Investments

Whilst trustees in the UK are currently required by various relevant laws to focus on sustainable investment, there are still times when fiduciary duties can limit sustainable investment.

Firstly, the UK legal framework requires trustees to follow the best interest’s principle in their fiduciary duties. For investment organisations, this requirement may limit the ability to consider sustainability factors in investment decisions when benefits cannot be maximised by taking ESG factors into account in the investment. For companies, although section 172 of the UK Companies Act 2006 requires company directors to consider the interests of stakeholders, it still requires that these considerations are based on the premise of “promoting the success of the company”.

Second, while the world’s environmental and social problems and the law require fiduciaries to take sustainability considerations into account when making investment decisions, this does not change the fiduciary duty. If sustainable investment behaviour is not consistent with fiduciary duty, the requirements of the law may


\textsuperscript{3} Companies Act 2006, c 46, s 172.


\textsuperscript{5} Companies Act 2006, c 46, s 416.


\textsuperscript{8} UK, Parliament, House of Lords (7 October 2008).
have an adverse impact on sustainable investment behaviour.

Finally, fiduciary duty requires trustees to manage the risk of the portfolio effectively, and the fact that sustainable investments may be subject to environmental regulations and social impacts and that there are no agreed criteria for ESG assessments makes it difficult to assess the risk of sustainable investment products. Trustees may therefore be constrained by the need to priorities these risks.

3. Conclusion

In summary, the fiduciary duties affecting sustainability investments are corporate fiduciary duties and intermediary fiduciary duties. The law is influenced by the context of the impact of sustainability on investment decisions and requires sustainable investment in the context of corporate fiduciary aspects in terms of decision-making by company directors, as well as in terms of corporate disclosure. For intermediary fiduciary duties, the statute requires trustees to consider ESG factors as an obligation and to use impact investing models through contracts, etc. In addition to this, the disclosure obligations in the UK Corporate Governance Code in relation to companies’ ESG activities help investors to understand and control the risks of ESG activities, which to a certain extent aids sustainable investing.

However, fiduciary duty has also limited the development of sustainable investment to a certain extent, as it is affected by the principle of best interests in the fiduciary duty, and fiduciary duty does not change the risks that may conflict with ESG behaviours and are difficult to anticipate and assess.

Fiduciaries therefore need to find a balance between requirements and limitations to facilitate the development of sustainable investments.

References


UK, Parliament, House of Lords (7 October 2008).


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