ESG Investing Meets Fiduciary Duty

Fiduciary Duty for a non-profit is easy to define: Fulfill your duties of Care, Loyalty, and Obedience…and adhere to the mission of the corporation as expressed in the Articles of Incorporation and other Founding Documents, (e.g. the Trust or the Will and any restrictions contained therein.) You must also adhere to the Investment Committee Charter, Investment Policy Statement, Bylaws, and Investment Policies and Procedures. There is also UPMIFA, the prudent person standard, and any controlling law. Whew, that was a lot! To complicate matters, these standards, specifically "prudent person", can and do evolve over time. (e.g. See wide acceptance of Modern Portfolio Theory)

ESG is a lens through which one evaluates an investment opportunity. Given the lack of precision as to what constitutes a proper definition of ESG investing, let's stipulate that the reader "knows it when he sees it." Your outside counsel can undertake a review to determine if there is an affirmative basis for legal approval for your institution to pursue "profits and purpose" or "value and values" investing. Outside counsel may/may not find specific support.

A fiduciary must focus on obtaining the best risk-adjusted return for the future beneficiaries of the Foundation and many organizations use ESG as one of several inputs. Certainly, ESG can be a factor in your analysis but it should not be a litmus test. If a specific investment achieves a high Sustainability rating, that alone should not be the single determining factor. Rather, as with any rigorous analytical process (e.g. CFA-type analysis), ESG can be a contributing and even material factor.

Possible Solution to support your ESG investing?

1) Document everything. Document a detailed investment review process that incorporates using an ESG lens. You are essentially "internalizing the externalities." E.g. Your investment decision to buy stock of a power company that relies heavily on nuclear power, can well incorporate the cost of future "stranded assets."
   You calculate those future costs against the expected future stock earnings. The expected value of the stock could well be adversely affected by these costs and your analysis would help you determine whether it is has been fairly-priced into the stock price. The results of your analysis might move the needle such that you do/do not invest. This may be a thoughtful and defensible approach. If the power company simply had a low sustainability rating, it is unlikely that this fact alone would be sufficient to justify not investing. Duty of care would likely require that you undertake a more detailed and thoughtful analysis and document it well.

2) Divestiture. It is a dramatic undertaking. You are eliminating part of the investment opportunity universe. Current research is at best mixed on that impact. (One should be especially beware of recent prognostications by law school professors as proclaimed in the WSJ.)

   NB: None of the comments in this article should be interpreted as providing legal advice.

Want to learn more? Please contact Chris Cutler or Tom Donahoe.