

Cambridge University Press

978-1-107-03587-4 - Cambridge Handbook of Institutional Investment and Fiduciary Duty

Edited by James P. Hawley, Andreas G. F. Hoepner, Keith L. Johnson, Joakim Sandberg and Edward J. Waitzer

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Cambridge Handbook of Institutional Investment and Fiduciary Duty

The *Cambridge Handbook of Institutional Investment and Fiduciary Duty* is a comprehensive reference work exploring recent changes and future trends in the principles that govern institutional investors and fiduciaries. A wide range of contributors offer new perspectives on dynamics that drive the current emphasis on short-term investment returns. Moreover, they analyze the forces at work in markets around the world which are bringing into sharper focus the systemic effects that investment practices have on the long-term stability of the economy and the interests of beneficiaries in financial, social and environmental sustainability. This volume provides a global and multifaceted commentary on the evolving standards governing institutional investment, offering guidance for students, researchers and policymakers interested in finance, governance and other aspects of the contemporary investment world. It also provides investment, business, financial media and legal professionals with the tools they need to better understand and respond to new financial market challenges of the twenty-first century.

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When people agree to become members of boards of pension organizations, what duties do they take on? This new book on fiduciary duty makes clear there is no simple answer to this question. It examines the subject not just from a legal perspective, but also from its implications for board behavior, investment policy, and the consideration of societal issues beyond the immediate confines of the pension plan. [It is] a valuable new tool for trustees.

Keith Ambachtsheer

Director of the International Centre for Pension Management at the Rotman School of Management, University of Toronto

Eight years after the Freshfields report, this handbook is a much needed in-depth analysis of the fiduciary duty of institutional investors. It is sharp, thoughtful and inspiring, and takes an interdisciplinary approach, ranging from finance, investment and law to philosophy and psychology. It is a must read for institutional investors wishing to understand and fulfil their fiduciary duties in a modern era.

James Gifford

Executive director of the United Nations-backed Principles for Responsible Investment

A focus on fiduciary standards in the investment chain is critical to the reform of the financial services sector to meet more effectively the needs of the non-financial economy. This book places the issue where it needs to be – on the centre of the stage.

John Kay

Professor at London School of Economics, journalist, and author of The Kay Review of UK Equity Markets and Long-Term Decision Making

This book is a thrice-blessed treasure: it meets society's needs to understand how the eclipse of fiduciary precepts has impoverished our commercial life; it meets the needs of governance professionals in providing a single repository of scholarly analysis of the various aspects of fiduciary duty; and it meets

the needs of everyday citizens in describing a world in which their expectations can reasonably be met. It is the right book at the right time by the right people. Congratulations to the Cambridge University Press and the Editors for timely bringing to the public such an essential contribution to public discourse – this book is instantly the must have for all who are interested in corporate governance or who invest money on behalf of others. The authors of the 36 component articles are such a luminous lot that one should not single out individual contributions. In brief, this is an instant classic – no finance or governance library should be without it.

Robert A. G. Monks

Author, entrepreneur, governance expert and former US pension and welfare benefits regulator

Fiduciary principles are under enormous pressure to narrow their reach; at the same moment in history forces shifting the ownership of assets from individuals to institutions argue for greater fiduciary scrutiny of investment decisions. By any measure, the importance of fiduciary principles has never been greater [than now]. The essays set forth in the Handbook are timely and deserving of becoming the intellectual North Star as the discussion of this centuries-old doctrine proceeds.

Knut A. Rostad

Founder and president, Institute for the Fiduciary Standard

This groundbreaking handbook is an insightful look into the real-world challenges of an investment industry navigating the ever-changing waters of the global economy. It shines a light on the risks that fiduciaries may face if they don't understand how the world is changing around them. The handbook is a must read for any investment fiduciary interested in a comprehensive interdisciplinary perspective.

Anne Stausboll

Chief executive officer of the California Public Employees' Retirement System (CalPERS)

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Foreword

The world currently faces increasingly complex governance challenges. While there is a growing recognition that we urgently need to take a longer-term view in order to deal with them successfully, many of the incentives that shape the thoughts and actions of leaders encourage myopia in the private and public sectors alike. Strategies with a high probability of success are available but not pursued because powerful short-term incentives are increasingly misaligned with the timeframes required for the solution of growing problems with profoundly destructive inter-generational impacts.

Thus far, legislators have not adequately addressed these inter-generational issues. In previous eras, when obvious and invidious injustices grew to intolerable scale due to the protracted paralysis of leaders, the necessity for action has often found its venue, by default, in the judiciary. Now, once again, courts – responding to specific fact situations – may well play a critical role in breaking this logjam. One likely legal strategy is based on the concept of fiduciary duty – the legal obligation to act in the best interests of others.

With the growth of specialization and interdependence, our increasing reliance on the services and expertise of others has given rise to the concept of a “fiduciary society” – a classic non-zero-sum game in which all can benefit. But if fiduciary obligations are betrayed and trust is eroded, it becomes a game in which all can lose. As a result, the values of *loyalty* and *trust* – shaped by “reasonable expectations” – have come to form the basis for broad fiduciary standards.

These developments have occurred in the context of a historically dramatic change in the ownership of almost all asset classes: public equity and debt, real estate, private equity, infrastructure assets and others. In the past, these types of investments were generally held by individuals. In the last thirty to

forty years they have come to be held mostly by institutional investors (e.g., pension funds, mutual and other retirement vehicles) – which, in turn, are fiduciaries for the majority of the adult population. As fiduciaries, they have duties of care and of loyalty which, many are coming to believe, should be extended to encompass attention to inter-generational fairness. In other words, the outcomes of fiduciaries’ decisions should reflect due regard for the best interests of future (as well as current) beneficiaries.

Meeting this challenge of fair treatment assumes a level of proficiency with respect to long-term value creation and risk mitigation. Arguably, these fiduciary standards impose obligations:

- To demonstrate respect for social norms;
- to give beneficiaries (or in the case of future beneficiaries, perhaps their proxies) a voice in decisions that affect their interests; and
- to think and act strategically and collectively.

To date, such standards have not been tested in the courts, but there is good reason to believe that they soon will be.

Investing is a means to ensure our future well-being. This requires a broader consideration by fiduciaries of systemic effects – for example, consideration of how investments can create better markets tomorrow, rather than simply focusing on “beating” the market today. Incentives that encourage fiduciaries to take advantage of asymmetries have frequently seduced fiduciaries to succumb to a self-destructive cycle of short-termism and have clearly generated unhealthy outcomes for the system as a whole.

It is only a matter of time before our courts (or regulators) will find opportunities to better define and protect the public interest. This is likely to lead to the imposition of public stewardship

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responsibilities throughout the financial services supply chain. We see elements of this today in the UK, and in the recent set of “investment beliefs” that CalPERS (the largest public pension fund in the US) recently adopted. Another example is the adoption of Regulation 28 in South Africa that requires that prudent investing should give consideration to “any factor which may materially affect the sustainable long-term performance of a fund’s assets, including factors of an environmental, social and governance character.”

Core to the stewardship idea is that human beings are the beneficiaries of their retirement funds. While this sounds obvious to many, far too often the funds themselves (and their relative, benchmarked performance) have been the primary or sole focus of short-term investment strategies. In order to better realize the goals of stewardship, the core concepts of fiduciary obligation will have to be rebalanced. For example, a rebalancing might shift at least some of the weight presently given to “prudence” (often defined as short-term performance relative to “peers”) to put greater weight on

“loyalty,” including a duty of impartiality to current and future beneficiaries.

Those who want to shape the process of fiduciary reform, rather than simply be subject to it, should read this volume of essays. This Handbook highlights the role that fiduciary duty plays in determining how managers of the world’s financial capital impact the sustainability of the economy, environment and society, as well as our future financial success.

Those large global financial institutions that are subject to fiduciary duties can and must play a crucial role in solving today’s most serious sustainability challenges. This volume brings together some of the leading practitioners, academics and policy makers confronting these issues. We hope and expect many of these ideas and lessons will have significant impact.

Al Gore

*Former Vice President of the United States
and Co-founder and Chairman of Generation
Investment Management*