Network for Sustainable Financial Markets

January 14, 2011

Adam Gray
Long-term Focus Consultation
Corporate Law and Governance
Department for Business, Innovation and Skills
1 Victoria Street
London
SW1H OET

Dear Mr. Gray:

We appreciate the opportunity to comment on the questions raised in the Department for Business Innovation and Skills consultation A Long-Term Focus for Corporate Britain. We are submitting this response on behalf of the Fiduciary Duty Working group of the Network for Sustainable Financial Markets (NSFM), which is an international, non-partisan, non-profit organization comprised of financial market professionals and academics.[1] NSFM was formed in 2008 in light of the financial crisis to bring the insights of theory and practice to bear on the need for a more stable and inclusive financial system, one that will harness the innovative capacity of the financial sector for maximum economic, social and environmental good.

NSFM seeks to focus research and debate on the underlying causes of financial market instability and on development of fundamental reforms, informed by seven broad principles. Stated quite generally these are as follows. First, the purpose of financial markets is to create long-term, sustainable value, which requires the efficient allocation of capital towards that goal. Sustainable value creation requires that hidden risks and rewards be identified and valued. A balance between short- and long-term views, strategies and behaviour is needed. Market participants must take responsibility for their actions. Better alignment of interests throughout the finance supply chain is needed to reduce agency costs. Finally, in an increasingly global marketplace, oversight bodies must evaluate aggregated cross-border risks to protect market stability; hence a coordinated global approach is needed to better protect integrity of the financial markets.

Much of NSFM's work to date has concentrated on the role of pension funds in the markets. As discussed below, there is a mismatch in many cases between pension funds' long-term liabilities, and their short-term investment horizon and strategies. This is a particular concern in light of the growing influence of pension funds in the markets, and their effects on

[1] *See* http://www.sustainablefinancialmarkets.net for further details about NSFM, its participants and research to date.

corporate behaviours. We believe that this mismatch undermines beneficiaries' interests.[2] It is from that perspective that we respond to this consultation, and particularly to the questions set out in Chapter Four.

Given pension funds' long-term liabilities and exposure to broad market returns for most of their earnings, we expect that well-managed funds would generally be concerned with the long-term profitability of the companies and economies in which they invest, which might provide the patient capital needed to support healthy, growing, innovative economies.[3] Indeed, there is evidence that leading public pension funds and sovereign wealth funds understand that long-term challenges affect the economic well-being of their beneficiaries, and are taking steps to analyze and address those challenges. For instance, the P8 in the U.K., under the leadership of the Prince of Wales and located at the University of Cambridge Programme for Sustainability Leadership, today comprises leaders from thirteen of the world's largest public pension funds and sovereign wealth funds, collectively valued at $3 trillion, working together to develop actions to address long-term global issues, particularly climate change.[4] As these funds state on the P8 website, they take a long-term investment perspective, and given their size and the nature of their mandates, they are "permanently exposed to the economic and human health consequences increasingly imposed by climate change."[5]

A number of collective initiatives among institutional investors more generally give further backing to the importance of taking a long-term perspective in portfolio management. The United Nation Environment Program Finance Initiative has developed, in consultation with the finance industry, Principles for Responsible Investment which provide a commitment to and mechanisms for the incorporation of environmental, social and governance information into investment decisions.[6] Such information is likely to be particularly salient for identifying long-term risks to investors' portfolios, and, in theory, lead to more socially productive allocation of capital. To date over 850 institutional investors, comprising $ 22 trillion of invested capital, have made commitments to use the Principles for Responsible Investment in their portfolio management activities.[7]

Notwithstanding these important initiatives amongst institutional investors recognizing the importance of a long-term perspective, the authors of this response agree that there is a problem with excessive short-term pressures on operating companies originating in capital markets. Indeed, institutional investors' portfolio turnover is often substantial, which brings heightened transaction costs, and often exceeds expected turnover ranges.[8] Academic research has found that pressure on corporate managers to deliver short-term investment results has

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[2] *See*, in particular, Modernizing Pension Funds' Fiduciary Duties for the Twenty-First Century, *available at* http://www.sustainablefinancialmarkets.net/2009/02/09/modernizing-pension-fund-legal-standards-for-the-21-century/. Portions of this Consultation Response are taken from that paper.

[3] About 75% of a typical fund's returns come from general exposure to the market (beta), not from alpha seeking strategies. See *Roger Ibbotson, The Importance of Asset Allocation,* Financial Analysts Journal *(March/April 2010*)

[4] *See http://www.cpsl.cam.ac.uk/leaders_groups/p8_group.aspx.*

[5] *Id.*

[6] *See http://www.unpri.org.*

[7] *See http://www.unpri.org/files/2010_Report-on-progress-press-release.pdf.*

[8] A 2010 study by Mercer and the IRRC Institute found that 65 percent of investment strategies produce higher portfolio turnover and have shorter investment horizons than intended. *See "Investment Horizons- Do Managers Do What They Say?" at http://www.irrcinstitute.org/projects.php?project=42.*

become so strong that nearly 80 percent of chief financial officers report they would sacrifice future economic value to manage short term earnings so as to meet investor expectations.[9] Some of the actions that these managers say they would take to meet analysts' expectations include delaying long-term investments, reducing research and development expenditures, or eliminating planned marketing campaigns. What is particularly troubling about this research is that the CFOs were generally more willing to take real value-destroying economic actions to meet analysts' expectations than to use accounting adjustments that would be considered proper, given the discretion both IFRS and U.S. GAAP provide.

The question arises , why the disparity between some institutional investors' recognition of the importance of long-term considerations to their economic well-being, and the short-term, quarter-by-quarter pressures from the capital markets that managers in operating companies report? Our response will focus on three explanatory factors we consider particularly salient: (1) interpretations of pension funds' fiduciary duties that have not evolved in conjunction with pension funds' evolution in the markets; (2) agency issues and conflicts of interest throughout the investment chain; and (3) the lack of consistent, comparable, high-quality information necessary to inform investors and analysts who do understand the importance of long-term risks. We will discuss each factor in turn.

(1) Interpretations of pension funds' fiduciary duties that have not evolved in conjunction with pension funds' evolution in the markets

In considering this issue, changes in the role and influence of pension funds and other institutional investors should be recognized.[10] Many assumptions underlying the way economists, policymakers and regulators have traditionally viewed pension systems no longer apply. Among the most important changes are the growth of pension funds into huge pools of capital and the correspondingly expanded influence that pension fund management practices now have on the larger economy.

For example, in the United States, institutional investor ownership of Fortune 1000 companies has increased to 73 percent of outstanding equity.[11] With retirement savings making up the largest block of those holdings, pension funds are central to health of the financial system and are a primary source of capital.[12] In some countries, the aggregate value of pension fund assets even exceeds the Gross Domestic Product.[13] Pension fund management practices clearly matter to the global economy.

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[9] John Graham, Campbell Harvey and Shivaram Rajgopal, *"Value Destruction and Financial Reporting Decisions,"* 62 Financial analysts' Journal 27, 27-29 (2006), *also available at* SSRN: http://ssrn.com/abstract=871215.

[10] We recognize that circumstances vary from one country to another. Pension fund governance is not a "one size fits all" matter. Nevertheless, we believe that most of the issues which fiduciaries face are similar across markets.

[11] Matteo Tonello, *"The 2010 Institutional Investment Report,"* The Conference Board (November 2010).

[12] *Id.* Pension funds accounted for almost 40 percent of institutional investor public equity holdings in the United States during 2009, totaling over $10 trillion.

[13] In 2009, pension fund assets exceeded GDP in Iceland and the Netherlands. The average pension assets-to-GDP ratio in 2009 for all OECD countries was 67 percent. In the UK, it was 73 percent. *Pension Markets in Focus,* Issue 7, July 2010, OECD.

Interpreting fiduciary duty to be solely about return on investment, and not holistic risk management, is still championed by many within the investment community and those who advise pension fund trustees. These interpretations are often ill-suited for the complex investment instruments and the market-moving amount of assets being managed by pension funds in the 21st century.

Fiduciaries are generally advised, based on traditional legal assumptions about pension funds from financial markets of the 20th century, to adhere to the same practices as are used by similar institutional investors.[14] Copycat investment behavior is encouraged by prevailing interpretations of the fiduciary duty legal standard. The result is a magnification of natural investor tendencies to engage in herding behavior, with pension funds pursuing the same strategies and investments. Given the exponential growth in pension assets since the 1970s, this produces added market volatility and new risks (even to the pension funds, themselves). In effect, what functioned as a "prudent expert" fiduciary standard 30 years ago has become more of a "lemming standard" that increases the severity of booms and busts and discourages adoption of improved practices that are not yet used by peers.[15] Pension funds are often reluctant to pursue prudent strategies not being widely used by other pension funds for fear of exposure to liability from breach of the "lemming" standard.

We submit that one implication of the damage contributed by a legal standard interpreted so as to encourage lemming behavior has been the unrelenting focus on short-term results. This phenomenon was examined by the investment industry's leading global authority on investor protection and financial market ethics, the CFA Institute Centre for Financial Market Integrity, and the Business Roundtable Institute for Corporate Ethics, which represents CEOs from 160 global companies. After engaging thought leaders from the corporate issuer, investment analyst, asset manager, institutional investor and individual investor communities, the study group concluded:

> "The obsession with short-term results by investors, asset management firms, and corporate managers collectively leads to the unintended consequences of destroying long-term value, decreasing market efficiency, reducing investment returns, and impeding efforts to strengthen corporate governance."[16] [Emphasis added.]

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[14] Under 29 USC §18.1104, pension funds subject to the Employees' Retirement Security Income Act (ERISA) must be managed "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." Under Dutch law, Pensioenwet Art 105, the term professionalism is used. In regard to investment policies, the conduct of a prudent person is referenced as the applicable standard (art 135). Furthermore, the law has delegated the interpretation of this law to the supervisory authority, the Dutch Central Bank.

[15] In the United States, little attention has been given to meaning of the ERISA introductory phrase in 29 USC §18.1104 which sets forth a separate, overarching requirement that fiduciaries *"shall"* discharge their duties "*in the interest of the participants and beneficiaries,"* imposing an obligation that is independent from the following phrase, *"and* for the exclusive purpose of providing benefits". [Emphasis added.] It appears that excessive investment herding behaviors, obsession with short-term performance and inattention to systemic risks, raises concerns about compliance with the first prong of the ERISA fiduciary duty clause cited above, because such practices may not be in the long-term interest of participants.

[16] "*Breaking the Short-Term Cycle,"* the CFA Centre for financial Market Integrity and Business Roundtable Institute for Corporate Ethics (July 2006), *available at* http://www.cfapubs.org/toc/ccb/2006/2006/1.

That a concern with short-term results leads to value destruction has been substantiated by academic research. While most mandates to asset managers are for a period of one to three years, performance is generally monitored on a quarterly basis against a peer/relative returns benchmark. Often if a number of quarters of underperformance coincide with the end of the mandate, assets will be moved to a different asset manager whose last few quarters coincide with higher than benchmark returns. Unfortunately this type of decision leads to the same result as does attempting to engage in market timing by an individual: money is lost, often on a significant scale. A recently published study confirmed prior findings that institutional investors eroded value from changing manager allocations based on a number of quarters of results:

> "By looking at the percentage difference in performance of those managers with the highest flows, and those with the lowest flows (by quintile), it concluded managers receiving contributions underperform those which experience withdrawals. Further this underperformance persists over one, three and five years, and can be up to 300 basis points.

Amanda White, *Investor Behaviour Erodes Performance*, Top 1000 Funds.com, *discussing* Scott Stewart et al., *"Absence of Value" An analysis of investment allocation decisions by institutional plan sponsors*, Financial Analysts' Journal (2009).[17]

These results also raise questions about whether fiduciaries are adequately addressing their separate legal obligation to handle conflicting interests of different participant and beneficiary groups impartially (e.g., producing current income for retirees while generating future wealth for young participants).[18] Excessive focus on short-term investment horizons, use of short-term benchmarks, and evaluation of portfolio managers primarily on short-term results, as well as inattention to risks associated with the potential long-term value destruction referenced above, should ring alarm bells for pension funds that are managing assets to meet liabilities extending out over generations. The <u>fiduciary duty of impartiality</u>, which has been given little attention, needs to be dusted off and re-examined.[19]

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[17] These research results were consistent with prior findings over more than a decade, as summarized in Watson Wyatt, *Hiring and Firing Managers*, April 2006.

[18] The duty of impartiality is summarized in official comments to §79(1) of the Restatement of Trusts, Third, as follows: "In what might be called the 'substantive' aspects of impartiality . . . Subsection (1) directs trustees . . . to make diligent and good-faith efforts to identify, respect, and balance the various beneficial interests when carrying out the trustees' fiduciary responsibilities in managing, protecting, and distributing the trust estate, and in other administrative functions." In its Trustee Toolkit, the UK Pensions Regulator also describes the duty of impartiality. *"As a trustee, you must consider the interests of all the classes of beneficiary covered by the trust deed and rules and act impartially."*

[19] The *Code of Conduct for Members of a Pension Scheme Governing Body* which was published by the CFA Institute Centre for Financial Market Integrity in 2008 also recognizes that an effective trustee will "consider the different types of beneficiaries relevant to each pension scheme" and "engage in a delicate balancing act of taking sufficient risk to generate long-term returns high enough to support real benefit increases for active participants who will become future beneficiaries while avoiding a level of risk that jeopardizes the safety of the payments to existing pensioners." In addition, in *Withers v. Teachers' Retirement System*, 447 F. Supp. 1248 (SDNY 1978), when the Court approved a New York City public pension fund investment in New York City bonds that were being issued to avoid the City's impending bankruptcy, it noted: "New York law imposes an obligation on trustees to accord impartial treatment to beneficiaries. It is more than evident, therefore, that the trustees of the TRS would have violated their fiduciary obligation had they exhausted the assets of an under funded actuarially reserved pension system on a single class of beneficiaries (retirees). Their obligation, plainly, was to manage the fund so as to enable it to meet its obligations not only to current retirees, but also to those scheduled to retire in the future, whose pension

One result of adopting a more balanced investment approach that considers long-term risks and future wealth generation, would be expansion of the risks and opportunities that are seen as relevant to a fund's investment strategy. The CFA Institute advises that pension fund governing boards, in addition to considering "typical financial measures," must consider "all relevant risk and value factors," which "may include environmental, social, and corporate governance issues."[20] Given the recent impact of corporate governance, systemic and intangible factors (e.g., risk management failure, automobile industry product obsolescence, regulatory agency inaction, loss of investor trust in market fairness) on pension funds in the economic crisis, there should be no doubt about the potential importance of extra-financial issues to long-term investors with broad market exposure.[21]

Unfortunately, most pension fund governance regulatory guidance on fiduciary and investment issues has taken a narrow view limited to quantitative measures. One by-product of the market crisis has been the realization that there are many investment risks that lie outside of what was traditionally quantified by mainstream investment consultants, advisors and portfolio managers. Systemic risks, which have been largely ignored, proved to be of great consequence. Now they need to be recognized and addressed as a fiduciary concern.

With most markets having eliminated statutory legal lists of allowed (or precluded) pension fund investments (a development which we heartily endorse), the task of determining appropriate investment risk exposures now falls completely on pension fund fiduciaries.[22] Their collective effectiveness in fulfilling these duties will not only determine the future well being of pension fund participants but will also play a major role in allocation of capital between companies and in health of the economy. The importance of pension fund governance and investment practices in this regard cannot be overstated. We provide some ideas for government policies that could assist in the development of fiduciary standards appropriate to the economic role of today's pension funds at the conclusion of this document.

(2) Agency issues and conflicts of interest throughout the institutional investment value chain

The translation into heterogeneous investment behavior of pension funds' long-term exposure to the risks of entire markets (rather than into herding, momentum investing, excessive churning of shares, and such),[23] is hampered by multiple agency problems within the investment supply chain. Asset owners and companies, at opposing ends of the investment chain, are in many

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and annuity rights would have been similarly earned over their years of active service and to whom the fund therefore had a legal responsibility."

[20] *Id.*

[21] Some regulators might need to revisit past interpretations of fiduciary duty in order to explicitly recognize risks that did not exist when fiduciary laws were originally written and pension funds had little collective influence on the markets or the broader economy.

[22] In Dutch law, the only investment restriction which still exists is a limit on investments in the company related to the fund (art 135). In Britain, Lord Mackenzie of Luton, Parliamentary Under Secretary of State for the House of Lords, representing the Department of Work & Pensions, summarized the Government's views on responsible investing by pension funds last October, "There is no reason why trustees cannot consider moral and social criteria, in addition to their usual criteria of financial returns, security and diversification."

[23] For an excellent analysis of these phenomenon and their causes see Alfred Rappaport, *The Economics of Short-Term Performance Obsession*, 61 Financial Analysts Journal 65-79 (2005).

instances unable to align their long-term interests because the investment chain is fragmented. Table 1 provides an overview of the problem.

Table 1. Main stakeholders in the institutional investor service provider supply chain

Stakeholder	Horizon (Average)	Agency problem	General description
Participants & Beneficiaries	30+ years	Often have/exercise little control over either their contributions or investments.	Are neither involved or knowledgeable, which leads to mistrust in times of financial instability.
Managers of companies	3 to 5 years	Only know a few vocal or active investors. In many countries less than 30 percent vote proxies. Little interaction.	Feel hunted and pressured to deliver quarterly returns by investors they do not know; are influenced by incentives based on stock price.
Investment Managers	1 year	Work for clients who provide mandates for 1 to 3 year performance, but who rarely tolerate consecutive quarters of relative underperformance	Are incentivized by fees set on assets under management and evaluated relative to market benchmarks, which might not reflect pension funding needs.

Based on Keith L. Johnson and Frank Jan de Graaf, "Modernizing Pension Fund Legal Standards for the Twenty-First Century," Rotman International Journal of Pension Management, Vol. 2, No. 1 (2009).

Given the prevalence of misaligned interests throughout the investment chain, the importance of identifying, realigning and managing the interests of pension beneficiaries and their agents should be a priority. Some specific examples of agency problems in the investment chain include the following:

A. Poor Stewardship

Pension beneficiaries (which we will call “asset owners,” even though as a legal matter the assets are not owned by the beneficiaries but are held in various trust arrangements) will generally be best served by fund managers who consider the long-term risks associated with their asset allocations and portfolio constructions. Good stewardship, i.e. monitoring of those long-term risks, including environmental, social and governance (“ESG”) risks, and taking appropriate action where concerns arise, is an important strategy to protect the long-term sustainability of returns for asset owners. Notwithstanding growing demand for stewardship from some clients, fund managers are often reluctant to act as good stewards on behalf of their clients, and so the responsibility for voting and corporate governance evaluation and engagement is outsourced to

specialist engagement overlay providers. There are a number of reasons for this reluctance. Two are particularly salient; the incremental costs of good stewardship reap benefits only in the long-run, and so not within the time frame of a fund managers' mandate; and fund managers have business relationships with a range portfolio companies, such as managing pensions within companies, and so will be reluctant to vote against management or be perceived as corporate governance activists generally.

While delegation to engagement overlay specialists would seem to be an efficient solution, it undermines the power of engaged owners by decoupling the buy/sell decision from ownership activities. Who, really, will companies listen to, the engagement overlay provider or the fund managers who make buy or sell decisions? Moreover delegation ignores the fact that individual portfolio managers do huge amounts of engagement all the time, but focused on the short-term and using narrow financial metrics. By so doing, portfolio managers send messages to corporations that are sub-optimal if viewed through the lens of long-term responsible ownership.[24]

B. Corporate disclosure

Asset owners are best served by discounted cash flow models that incorporate timely, accurate, and credible financial information, as required by regulation. Share prices would more accurately reflect fundamental values (albeit never perfectly) if companies were also to disclose environmental, social and governance information in consistent, comparable format, perhaps using quantitative key performance indicators,[25] thus allowing fund managers to evaluate more accurately a broad range of risks. Active fund managers have an incentive to defend their competitive advantages, including with respect to information (i.e., having a superior ability to interpret available information), but have fewer incentives to promote broadly available information about companies. The aborted Operating and Financial Review (OFR), for example, gained less support amongst fund managers than might have been expected.[26] Narrative reporting is of more relevance to asset owners than to their fund managers, because it provides them with knowledge of companies potentially closer to that gained by fund managers in their ongoing dialogue with companies, enabling better oversight over their managers' investment decisions and stewardship activities.[27]

C. Managing to benchmarks

Most mandates to asset managers identify success as performance relative to benchmarks that are composed of indices relevant to the different asset classes into which the asset owners' funds are being invested. Yet there is no necessary connection between the performance of the

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[24] AXA Investment Management, "*Should asset owners outsource "active ownership" responsibilities to engagement overlay providers?" July 2008*.

[25] For thoughtful discussions of key performance indicators see Robert Eccles and Michael Krzus' *One Report: Integrated Reporting for a Sustainable Strategy*; the Institute for Responsible Investment (Steve Lydenberg and David Wood), *From Transparency to Performance: Industry Based Sustainability Reporting on Key Issues*; or DVFA (Alexander Bassen and Ralf Frank) *Key Performance Indicators for Extra-Financial Analysis.*

[26] *See* Cynthia A. Williams & John M. Conley, *Triumph or Tragedy? The Curious Path of Corporate Disclosure Reform in the UK* , 31:2 WILLIAM & MARY ENV. L.J. (2007).

[27] Local Authority Pension Fund Forum, *Holding Fund Managers to Account*, October 2006.

benchmark and the beneficiaries' ultimate financial interests— fund managers may destroy value for the asset owner in absolute terms, but still outperform the benchmark. Benchmarks are used for ease of administration and for convenience in judging the performance of the asset managers; we believe it unlikely that the market will move away from them. An emerging practice is to include environmental, social and governance (ESG) factors into the design of indices and benchmarks, and to link stewardship activities to the index .

In general, it is possible to minimize the impact of agency issues and conflicts of interest, but they cannot be eliminated entirely. In most of the cases discussed above, the individual signing for the client is satisfied with the arrangements, as are the asset managers. Whether these arrangements serve the asset owners' interests is a separate matter. Clients, it turns out, have limited influence even when they try to change "standard" mandate arrangements. We are aware of clients whose attempts to encourage a longer-term orientation and broader consideration of ESG factors in fund management mandates have been met with refusal by asset managers across the board, the common defence being that "none of our other clients have asked for this, we don't know how to price it, we won't do it." In essence, the investment supply chain works in reverse: asset managers dictate the general terms (the tail wags the dog).

(3) Lack of consistent, comparable, high-quality information necessary to inform those institutional investors that understand the need to take a long-term perspective

If the long-term perspective that is articulated by leading institutional investors is to be translated into investment management, the quantitative tools that investors use must be considered. The language of markets is accounting. This point suggests a number of approaches to consider. International Financial Reporting Standards ('IFRS') could be revised to include measures for all of the positive and negative social and environmental externalities companies produce. So, for example, when companies invest in training their employees, that investment could be treated as a capital investment, not as a cost. When companies use water, produce greenhouse gas emissions or other pollution, undermine habitats, those could be treated as costs. Measures such as Yale University environmental economist Robert Repetto's 'True Economic Value Added', which incorporates measures of environmental harm into an integrated measure of financial results, have been developed with intellectual rigor and are ready to be implemented into national and international accounting standards.[28]

As discussed above ("Corporate Disclosure"), companies should be required to disclose specific environmental, social and governance data, including discussions of how boards of directors are evaluating human rights, social and environmental risks, and what stakeholder consultations inform the company's analysis. We submit that the requirements of the Business Review, now that they've been implemented for five years, are ripe for evaluation: How good is the information that has been disclosed, how specific, how useful?

[28] Robert Repetto and Daniel Dias, 'TRUEVA: A New Integrated Financial Measure of Environmental Exposure, *Yale Center for Environmental Law and Policy, Working Paper No. 200602*, 15 October 2006.

The way forward

There are a number of steps the Government could take to address the issues identified in this response to the consultation. One approach is for the Government to constitute an Expert Panel to evaluate the language of "standard" mandates between asset owners, particularly pension funds, and asset managers. Using participants from various links in the investment supply chain, such a panel could recommend best practice language to incorporate into "model mandates" where such mandates would be developed to reduce conflicts of interest, allow a longer time-frame for fund manager evaluation, and, most important, encourage asset managers to incorporate ESG factors and broader frame of reference for evaluation of systemic risk. The International Corporate Governance Network is currently working on better practices for asset owners in contract mandates for investment managers and more balanced monitoring processes, an effort that would be complemented by a Government Expert Committee process.

Another approach would be for the Government to provide guidance on the concept of fiduciary duty that addresses the gaps between facts of how the pension industry has developed (its influence on economy and the power of the service provider chain, which operates with a greater tolerance for conflicts of interest that would breach the duty of loyalty if Trustees had the same conflicts) and what is in the "impartial" best interests of all beneficial owners (who are largely invested long-term in order to meet long-term liabilities). Alternatively, it might be worth considering providing greater liability protection for fiduciaries and their service providers who do not have the pervasive conflicts of interest so common in the investment chain. So one might consider shifting the burden of proof or changing the standard of proof for liability when there are structural, compensation or behavioral indicators of misaligned interests, or where model mandates or stewardship arrangements do not comply with best practices on a comply or explain basis.

The Government's range of policy tools is not limited to convening Expert Panels to develop voluntary best practices or providing better guidance for pension trustees, however. A number of research institutes and authors have identified ways in which tax laws could be modified to discourage short-term trading, reflecting the often unrecognized costs to society and risks to pension beneficiaries such trading creates.[29] Variations in voting rights to reflect varying ownership periods have also been suggested.[30] Changing financial and corporate governance incentives through such mechanisms may more effectively remedy the problem of an excessively short-term orientation in the capital markets than will voluntary best practice, although the difficulties of national responses to a global problem must be acknowledged.

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[29] *See for instance* The Aspen Institute, *Overcoming Short-Termism: A Call for a More Responsible Approach to Investment and Business Management*, September 2009 (discussing three leverage points for overcoming short-termism: revising tax policy; adopting policies to better align the interests of financial intermediaries and their ultimate investors; and greater transparency about the content of asset managers' mandates, compensation, and financial incentives); Con Keating, *Don't Stop Thinking About Tomorrow: The Future of Pensions* (Long Finance: 2010), *available at* http://www.zyen.com/LongFinance/Long%20Finance_FutureofPensions.pdf (discussing tax and other policies to encourage a longer-term orientation to finance and to reform and strengthen pension provision in the U.K.).

[30] Andrew Haldane, Executive Director, Financial Stability, Bank of England, *Patience and Finance*, *available at* Bank of International Settlements Review 114/2010 (discussing both tax and corporate governance approaches to the problem of impatient capital).

We appreciate the opportunity to provide the views of individual participants of the Network for Sustainable Financial Markets, as set out below. We commend the Government for taking up research and analysis of this important issue.

Sincerely,

Ann Byrne, Frank Jan de Graaf, Cynthia Williams and Keith Johnson, Co-Chairs
Fiduciary Duty Working Group, the Network for Sustainable Financial Markets

Additional Network for Sustainable Financial Markets' Participants:[31]

Keith Ambachtsheer, International Centre for Pension Management, Rotman School of Management, University of Toronto

Mark Campanale, Four Elements Capital, Ltd.

Greg Chipman, Managing Director CJC Global; Director RIAA

Stephen Davis, Senior Fellow, Millstein Center for Corporate Governance and Performance, Yale School of Management

Jonathan Hayward, Independent Audit, Ltd.

Dr Andreas Hoepner, Lecturer in Banking & Finance, School of Management, University of St. Andrews; Co-Director of Finance, School of Management, University of St. Andrews; Academic Fellow, Principles for Responsible Investment, United Nations

Sean Kidney, Chair, the Climate Bond Initiative

Maxine Le Floc'h, Responsible Investment Analyst for a large investment manager

Nick Kalikajaros, CJC Global Advisors

Dr. Jeremy Leggett, Executive Chairman, Solarcentury

Prof. Michael Mainelli, Z/Yen Group Ltd.

Richard Murphy, Tax Research LLP

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[31] Signatories are signing as individuals, and not on behalf of any organization other than NSFM. Organizational affiliations for identification purposes only. Information on NSFM and its participants is available at www.sustainablefinancialmarkets.net.

Michael Musuraca, Blue Wolf Capital Partners

Patricia Nwobodo, NSFM Participant, Nigeria

Steve Podmore, Founder & CEO, Transform Capital Management Ltd.

Prof. Poonam Puri, Associate Professor of Law, Osgoode Hall Law School, York University

Charles Scanlon, NSFM Participant, UK

Dr. Alister Scott, Visiting Fellow, SPRU, University of Sussex Business School

Nick Silver, Director Climate Bonds Initiative; and Director, Callund Consulting Limited

Peter Sweatman, Chief Executive, Climate Strategy & Partners

Matteo Tonello, Director, Corporate Governance, the Conference Board

Prof. Ed Waitzer, Janislowsky Dimma Mooney Chair in Corporate Governance, Schulich School of Business and Osgoode Hall Law School, York University

David Wood, Director, Initiative for Responsible Investment, Harvard University