August 6, 2018

Brent Fields
Secretary
U.S. Securities & Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090

Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation – File No. S7-09-18

Dear Mr. Fields,

The Principles for Responsible Investment (PRI) is the world’s leading initiative on responsible investment. Launched in New York in 2006, the PRI has grown to over 2,000 signatories, investing $80 trillion and it is still growing. The U.S. is the PRI’s largest market.

Integrating Environmental, Social and Governance (ESG) factors has become a necessary part of investment. In the context of market volatility, climate change and regulatory intervention, ESG factors offer an expanded set of tools to address unmet investment industry needs in accordance with fiduciary duties.

The PRI welcomes the opportunity to respond to the request for comment under section II, Investment Advisers’ Fiduciary Duty. The PRI recommends that the SEC clarify that economically-relevant ESG factors are part of a prudent investment decision, and a requirement of an adviser’s duty of care and duty of loyalty. The PRI recommends this is codified under section 206 of the Advisers Act. The PRI supports ILPA’s recommendation that the SEC rescind the Heitman Capital Management no-action letter.

The PRI agrees that fiduciary duties exist to ensure that those who manage other people’s money act in the interests of beneficiaries. The most important of these duties are:

- Loyalty: Fiduciaries should act in good faith in the interests of their beneficiaries, should impartially balance the conflicting interests of different beneficiaries, should avoid conflicts of interest and should not act for the benefit of themselves or a third party.

1 The Commission requests comment on the proposed interpretation regarding certain aspects of the fiduciary duty under section 206 of the Advisers Act:
   - Does the Commission’s proposed interpretation offer sufficient guidance with respect to the fiduciary duty under section 206 of the Advisers Act?
   - Are there any significant issues related to an adviser’s fiduciary duty that the proposed interpretation has not addressed?
   - Would it be beneficial for investors, advisers or broker-dealers for the Commission to codify any portion of our proposed interpretation of the fiduciary duty under section 206 of the Advisers Act?

Prudence (or care): Fiduciaries should act with due care, skill and diligence, investing as an ‘ordinary prudent person’ would do.

The PRI has prepared a substantial evidence-base on fiduciary duties and responsible investment, across multiple markets.

The PRI’s 2015 *Fiduciary Duty in the 21st Century* report found that:

> Failing to consider long-term investment value drivers, which include environmental, social and governance issues, in investment practice is a failure of fiduciary duty.

> ... despite significant progress, many investors have yet to fully integrate ESG issues into their investment decision-making processes ...

> [Advice given by consultants] – in particular in the U.S. – is often based on a very narrow interpretation of fiduciary duty ... most consultants tend to advise their clients that the law requires them to have exclusive focus on financial returns, often in the erroneous belief that taking account of ESG issues will have a negative impact on investment returns.

The PRI’s *U.S. roadmap* sets out why ESG integration is a fiduciary requirement:

Neglecting analysis of ESG factors may cause the mispricing of risk and poor asset allocation decisions.\(^2\) It is worth clarifying that, in our view, ESG integration does not necessarily involve a narrowing of the available investment universe (unlike negative screening). Neither does it involve relegating the pursuit of a financial return to unrelated objectives (social or ethical). It does though provide investors with an expanded set of tools for evaluating the operational performance and financial prospects of investee companies. ESG analysis is increasingly assisting investors to identify value-relevant factors undetected by out-dated financial-only analysis.

The content of a prudent investment decision changes over time. We can see this in the expansion of the disclosure requirements under Regulation S-K. Over recent decades that framework has expanded to include reporting on a corporation’s liquidity, capital structure, derivative instruments and off-balance sheet transactions. This reflects the evolving tools and techniques of prudent investment analysis. It is important to understand that ESG integration is less a product than it is part of the broader process and technology of investment analysis. Ultimately, the consideration of ESG factors has become one of the core characteristics of a prudent investment process.

[and]

> ... sponsors and trustees should be supported with guidance. Such guidance should outline methods for interacting with investment consultants to drive value and ensure that advice and investment processes are subject to searching analysis. Given the content and requirements of fiduciary duties, plan sponsors and trustees should be assisted in interrogating whether their consultants are reflecting the fiduciary duties against which they are held in the scope and content of their investment advice. Practical recommendations on interactions between plan sponsors and trustees and investment

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\(^2\) There are multiple studies demonstrating the economic relevance of ESG factors to investment portfolios (for example, the PRI’s financial performance of ESG integration in U.S. investing).
consultants could be made, to ensure the consideration of material ESG issues in investment processes.

Guidance could indicate that plan sponsors and trustees request and review their investment consultant’s stated investment strategies; request an assessment of the depth of ESG skills of relevant staff (and their location within the investment consultant’s business); and embed ESG reporting expectations into mandates and performance reviews of investment consultant practice – including the time-horizon against which investment choices are being made and assessed.

The PRI welcomed guidance from the Department of Labor (DOL) in October 2015, and again in 2018, which stated that economically-relevant ESG factors were part of a prudent investment decision.

The PRI recommends that the SEC clarify that economically-relevant ESG factors are part of a prudent investment decision, and a requirement of an advisers’ duty of care and duty of loyalty. The PRI recommends this is codified under section 206 of the Advisers Act.

The PRI also supports ILPA’s recommendation that the SEC rescind the Heitman Capital Management no-action letter^3, to prevent the continued abuse of the objectives of the Advisers Act and ensure that private fund advisers may not be permitted to continue to disclaim their fiduciary duties under state law. Changes to Delaware law in 2004, along with this relief provided by the SEC in 2007, have resulted in the ability for private fund advisers to disclaim their duties of care and loyalty in the contract signed between investors and managers, also known as a “hedge clause”. This has provided an incentive for private fund managers to disclaim these duties, as a result of the strong fundraising environment, countering the aims of the Advisers Act, and resulting in a less efficient market, increased litigation, and particular harm to smaller investors without negotiating power.

We appreciate the opportunity to share our views on the proposed interpretation.

Yours sincerely,

Fiona Reynolds
Chief Executive Officer
Principles for Responsible Investment

cc. The Honorable Jay Clayton, Chairman
The Honorable Kara M. Stein
The Honorable Michael Piwowar
The Honorable Robert J. Jackson, Jr.
The Honorable Hester M. Peirce

For further analysis, see:

- Fiduciary Duty in the 21st Century

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^3 Heitman Capital Management, LLC, SEC Staff No-Action Letter (February 12, 2007).
- U.S. Roadmap
- Investment Consultant Services Review
- Financial Performance of ESG Integration in U.S. Investing