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CFA Institute Research & Policy Center

CFA Institute Views on Fiduciary Duty in the Context of Net-Zero Investing

In June 2024, CFA Institute set forth its approach to net-zero investing.[1] As we said then, the issue of net-zero investing is complicated and involves many facets of the investment industry. In November 2024, we address one of the more vexing complications in this debate: whether net-zero investing is consistent with fiduciary duty. More specifically, is integrating net-zero factors into a traditional fundamental investment process somehow *prohibited*, *permitted*, or *required* by fiduciary duty? This issue has been the subject of much debate across the financial, legal, and political spectrums, and to date, no single, unifying answer has emerged.

We start with our high-level view of fiduciary duty—an obligation that is foundational for investment professionals. As we stated in our "Net Zero in the Balance" report,[2] while there is no single globally consistent interpretation of fiduciary duty, two key concepts are widely followed that we firmly support:

- Loyalty: acting in accordance with the specific power of investment by putting the interests of beneficiaries first and avoiding conflicts of interest
- Prudence and care: investing prudently, exercising good judgment and reasonable care, and diversifying according to accepted investment theory

We also recognize that in some parts of the world, the fiduciary scope is widening beyond the risk–return analysis to include the real-world impact of the investment. For our purposes, however, our views focus on loyalty and prudence only in the risk–return equation.

[1]CFA Institute, "CFA Institute Views on Net Zero" (June 2024). https://rpc.cfainstitute.org/-/media/documents/policy/public-statement-on-net-zero.pdf.

[2]Roger Urwin, "Net Zero in the Balance: A Guide to Transformative Industry Thinking," CFA Institute (June 2024). https://rpc.cfainstitute.org/-/media/documents/article/industry-research/net-zero-in-the-balance.pdf.

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To help further shape the discussion, in November 2024, CFA Institute sets forth its top-line views on fiduciary duty in the context of net-zero investing. In our role as a financial educator, a policy thought leader, and a professional membership organization, our views are informed by industry practitioners, policymakers and regulators, asset owners, and other stakeholders—virtually all aspects of the investment management industry.[3]

Our June 2024 views on how we define net zero and net-zero investing remain our starting points. Net zero is a potential future state where the net increase—that is, emissions minus removals—in heat-trapping air pollution is zero. We see net-zero investing as being more nuanced; in our view, it involves four important objectives: (1) to attain one's risk and return objectives; (2) to mitigate the financial risk of climate change on an asset owner's investments; (3) to profit from the long-term, macroeconomic opportunities that will result from climate change (e.g., technological advancements, adaptation of physical structures); and (4) to work toward net-zero objectives and eventually attain net zero consistent with objectives (1–3). We also note that some investors value the benefits of attaining global net zero beyond its contribution to risk and return (e.g., a better society), while others focus solely on the risk and return benefits.

Within the overall context set forth above, here are our **seven** top-line views on fiduciary duty in the context of net-zero investing:

1. **At its core, a fiduciary is expected to balance risks and returns to achieve maximum financial benefit within certain risk parameters.** There are numerous material risks a fiduciary must consider, including material climate change risk, as well as different time horizons over which risks apply.
2. **In balancing these risks and returns, a fiduciary is expected to consider all factors that are financially material to the investment decision.** Thus, the consideration of climate risks (regardless of whether they underlie net-zero investing) is firmly rooted in a fiduciary's duty to analyze material risks when making any investment decision, particularly in the context of physical and transition risks. Put simply, a fiduciary has an obligation to engage in prudent climate risk management, irrespective of whether the fiduciary engages in net-zero investing.
3. **In doing so, fiduciaries should recall that there is a wider system—the economic and financial system—within which investment decisions are made.** As such, there may be a range of material factors to consider, including such things as systemic risks,[4] particularly as balanced against possible returns. It is for the fiduciary to weigh these factors in making investment decisions consistent with applicable time horizons.

[3] We note that there are two types of fiduciaries—those that govern the assets (the board) and those that invest the assets (asset managers or portfolio managers). Our views relate to the latter type of fiduciary.

[4] For our purposes here, we define systemic risk as the possibility of a cascading failure in the financial system, caused by a single event or related events, due to the interlinkages within the financial system, resulting in a severe economic decline.

4. **In carrying out their duties, particularly in assessing what material risks to consider, fiduciaries can assess whether net-zero investing aids in mitigating long-term risks associated with climate change, such as physical damage to assets, business profits, transition risks depending on public policy responses, regulatory changes, and market shifts.** By considering these issues, fiduciaries can protect, and potentially enhance, the long-term value of their investments.

5. **Within the wider economic and financial system, fiduciaries who consider climate issues (which underpin net-zero investing) do so to improve returns and reduce risks.** With a wider system view, new, unmanaged risks may emerge or opportunities may be revealed, particularly related to the reactions of policymakers, regulators, and investors to these issues.

6. **In some instances, it may be appropriate for fiduciaries to consider an investment strategy that rejects short-term gains if taking those gains creates identifiable risks to the longer-term sustainability of investment returns.** In these cases, fiduciaries should be transparent and discuss these considerations with their investors.

7. **Once an investment decision is made (with or without net-zero considerations in mind), fiduciaries should consider whether they can improve an investment's return or lower its risk by engaging in stewardship activities.** By engaging in these activities, fiduciaries will be better able to influence their holdings, assess embedded risks in the investment, and understand the future cash flow of the investment. At the same time, fiduciaries have the opportunity to influence regulators and policymakers (and perhaps others) to improve the overall system that supports future investment returns.

As we noted in our June 2024 statement of policy views on net-zero investing—and equally true here—in terms of direct industry value creation, we aim to

- build the capacity of the investment profession in this area by researching, curating, and promoting the knowledge, skills, tools, practices, and abilities needed to analyze and act on the financial risks and opportunities of climate change and a transition to a low-carbon economy;
- use the convening power of CFA Institute and our access to our diverse and highly informed membership to promote engagement, knowledge sharing, and collaboration on this complex issue; and
- advocate for policies that are conducive to our mission and to end investors.

CFA Institute Research and Policy Center provides an ideal platform to generate research and thought leadership in this area. Furthermore, it can become a leading medium to curate and offer third-party research and to build tools that provide actionable insights to market practitioners in the area of net zero, in general, and fiduciary duty, in particular.

ABOUT THE RESEARCH AND POLICY CENTER

CFA Institute Research and Policy Center brings together CFA Institute expertise along with a diverse, cross-disciplinary community of subject matter experts working collaboratively to address complex problems. It is informed by the perspective of practitioners and the convening power, impartiality, and credibility of CFA Institute, whose mission is to lead the investment profession globally by promoting the highest standards of ethics, education, and professional excellence for the ultimate benefit of society. For more information, visit https://rpc.cfainstitute.org/en/.

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