

Sustainable Fiduciary Duties – How fiduciary duties can be a key to escape the climate prisoner’s dilemma

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Investment managers, pension funds, banks, and insurers increasingly face the question of what they can or must do to deal with the growing climate and biodiversity crises. Should they just ignore them and keep their eyes on bigger profits, or should they actively pursue climate and nature impact in their investment policy? Should they get rid of fossil fuel investments, or keep them and use their rights as shareholders to try to convince the investee companies to clean up their act?

NZLA has an “accelerator group on fiduciary duties” that is studying this. An -- updated -- [draft discussion paper](#) written for the project summarizes the law as it stands, focusing on the UK but with implications in other common law jurisdictions and beyond.

Here’s the bottom line: The law of fiduciary duties has a key role to play to help solve the climate crisis. How? By recognizing that preserving and maximizing financial returns on investment, in the interest of beneficiaries, means (1) actively pursuing climate mitigation and (2) ensuring that investee companies and public authorities do so, too.

The law says fiduciaries must act within the limits of their powers, in the “*best interests*” of the beneficiaries who put their trust in them, and exercise care and prudence.

Let’s focus only on maximizing financial returns. Even if we do that, trustees and other fiduciaries can no longer ignore climate change and nature loss. Ignoring it endangers the value of their investments. A worrying [2024 study](#) discussed in the paper estimates that assets held by investment funds, pension funds, and others stand to lose as much as 40% of their value (in today’s terms!), if we continue with business as usual. This loss will be priced in sooner or later, gradually or in shocks. Either way, this is financially material.

The damage can be much less – below 10% – if we reduce emissions of greenhouse gases, but it can also be 50% or more if we don’t, and climate tipping points happen.

Here’s why: The cause of climate change is, in essence, a market failure. The price of goods and services we use includes the cost of production, but not the cost of nature loss or global warming caused by production and consumption. Similarly, if a fund insures or invests in dirty assets to get short-term profits, the resulting emissions create climate damage to *all* of its investments (and those of everyone else). Those hidden costs are not included in the profits or return on investment. Most investment managers or insurers ignore them. Those who don’t – and there are more and more of them – have little incentive to stop investing in dirty assets unless everyone else stops, too. So we keep racing each other to the edge of the cliff.

Recent studies confirm that the cliff is steep, and the edge is getting close. A Stanford and Northwestern University study estimates costs of climate change as high as 29% of the world’s GDP. This is “the costs of the 1929 Great Depression, forever”. So we must transition - if only for economic reasons. The British Institute and Faculty of Actuaries – no intellectual adventurers – fears that we could lose 50% of our GDP, and that doesn’t even count the loss of biodiversity, beauty, and quality of life as we are plagued by increasing heat, floods, fire, extreme weather

changes, and war. This [TED Talk by Johan Rockstrom](#) explains it well. Imagine swathes of equatorial regions becoming so hot and dry that many millions of climate refugees are forced to flee.

Some say that investors in the West don't have to act until the danger is imminent, severe, fast acting, and cashflow relevant. But that means waiting until we can no longer turn around. Climate change it is already a clear and present danger. Tipping points such as the slowdown of the North Atlantic Subpolar Gyre may have dramatic impact in Europe and the US, and may happen within two decades, even below 2°C warming. We have to act now if we want to stop that. Here is a readable but chilling Financial Times article: [The utterly plausible case that climate change makes London much colder](#) (Jan 11, 2025). If this happens, *we all* might be the refugees. Our world will become uninsurable, and a board member of one of the largest insurance companies [concludes](#) that "*the financial sector as we know it ceases to function.*"

The precautionary principle says that if the stakes are so high, we can't wait until everyone is certain this will happen soon. It would be too late. The impact would be irreparable and so great that, in the best interest of beneficiaries, fiduciaries must do what is in their power to minimize and prevent it, and do that now. Maybe it's expensive to transition – in our own self-interest we'd have to help the countries that can't afford it – but *not* transitioning would be devastatingly more expensive.

On the encouraging side, an [Oxford University study](#) explains that if we transition without delay, the range of expected savings is \$88–\$775 trillion. A report for the Bruegel thinktank ("[The economic case for climate finance at scale](#)") calculates that the net (!) benefits of just switching out of coal worldwide are as much as \$ 78 trillion. Trillions, not just billions. There is a huge economic upside, and a promise of cheaper and cleaner energy for our (and the world's) economy. It will cost \$ 29 trillion to help the dozen or so countries that still widely use coal to transition to clean energy, but the upside is at least \$ 114 trillion gross – \$ 78 trillion net. And that's just for dumping coal.

So, what can and must investors, pension funds, banks, insurers, asset managers and others do?

First, do no harm. Continuing to invest in new unabated high-emission projects is not an option. We might get a good short-term return on an individual "dirty" asset, but at a much greater and longer-lasting portfolio-wide cost. If we naively keep hoping that climate change won't be too bad, and will only affect others, that will lead to liability claims, dirty investments becoming useless and stranded, physical and financial damage from extreme weather events, and even a risk of economic crises and collapse in the years to come. Climate change is a systemic risk. Financing, insuring, or facilitating it is a violation of fiduciary duties.

Imagine, for instance, a pension fund investing in dirty assets to pay current retirees. Those investments are at the expense of increased risk of massive damage to future pensioners. It would be a breach of trust towards the latter.

Second, take action. The discussion paper explains that even under current law fiduciaries have not only a *right*, but a *duty* to integrate climate risks in investment decisions. When the facts change, the outcome of the application of the law changes. And we shouldn't just *think* about climate risks as one factor amongst others before they make decisions, but must take affirmative *action* to:

- (a) stay away from investments in new unabated (or not fully and effectively abated) high-emission projects and from giving new finance to companies engaged in such projects;
- (b) pursue viable climate impact investments in clean energy, and climate mitigation and adaptation; and

- (c) follow an active stewardship policy to encourage investee companies to transition to a sustainable business, too, and
- (d) forcefully lobby governments everywhere for effective worldwide climate action.

Acknowledging this as a universal fiduciary duty, and enforcing it as such, is in the best financial interest of current and future customers, beneficiaries and shareholders because it helps resolve the collective action problem that currently hampers effective climate action – and so lowers the potentially huge risks and costs of an unmitigated climate crisis.

Doing this is in everyone's financial (and other) best self-interest. As Lukomnik and Hawley explain in *Moving Beyond Modern Portfolio Theory: Investing That Matters*, effectively addressing systemic risks is vastly more rewarding and effective to preserve value and to get good investment results than the traditional asset diversification pursued by modern portfolio management.

Investors should act on this, and Government should explicitly reflect these existing principles in FCA and TPR Guidance, in the "Value for Money" framework and a new Pension Schemes Bill, as well as the legislation for the National Wealth Fund and similar initiatives.

The draft discussion paper can be found [here](#). Comments are still welcome!

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"Yes, the planet got destroyed, but for a beautiful moment in time we created a lot of value for shareholders."

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¹ This blog and draft discussion paper are written for the Secretariat of the [Net Zero Lawyers Alliance](#), as part of the NZLA project on fiduciary duties. They reflect our personal perspectives, and do not bind the firm, its clients, or those who kindly commented on the draft paper. This blog and the draft discussion paper were not written for or at the request of, or paid for by, any client.