

## The Real Fiduciary Failure is Ignoring Material Sustainability Information

The latest attack on “ESG” is undermined by the same fundamental flaws as previous arguments, treating a broad spectrum of investment practices as a single, monolithic ideology. NorthPeak counters the latest argument highlighting what investors are actually doing when they implement responsible investment practices to meet fiduciary duty.



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Investors who ignore material sustainability risks are not being more rigorous fiduciaries; they are less informed.

A pension fund trustee who is presented with credible analysis of physical and transition climate risks to their portfolio, and who chooses to ignore it on the grounds that climate was "non-financial" and considering it was ideologically based, would face legitimate scrutiny about their own discharge of fiduciary duty.

### The Label Problem

The debate about “ESG Investing” has made this basic point of fiduciary management harder to see, collapsing a broad spectrum of distinct investment practices into a single label. This is a problem I highlighted in a 2021 article for AIMA’s Journal titled [‘The ESG Label’](#). I was writing from within the responsible investment space, advising fund managers on the implementation of responsible investment processes. At that point in time we were facing questions based on the misuse of this label; fund managers were asking how to become “ESG compliant” as if there were a single defined standard, and allocators were asking asset managers “how do you think about ESG?” as if the answer could be a single coherent position. ESG investing, as the label was being used, could never be a single standard

or position due to the multiple practices people implemented. My colleague Benjamin Stone made a similar point in his 2022 article '[The Perversion of ESG Investing](#)', noting how the misuse of the label had invited backlash from politicians in the US.

Last month a UK think tank, the Prosperity Institute, published a paper '[The Death of the Fiduciary Duty](#)' that makes an argument that has been well versed. Despite making some legitimate criticisms this paper's central view is flawed.

The paper treats "ESG" as if it were a single, coherent, uniformly implemented investment philosophy, which is a lazy misrepresentation of the term. **ESG is not a single investment approach and never has been.** Until critics of responsible investment reckon with that, they will continue to attack a straw man, arguing against a perception of "ESG" that simply does not exist in the form they describe.

## The Broad Spectrum

The responsible investment spectrum runs from simple exclusionary screening (removing tobacco or weapons from a portfolio, or excluding investments with a specific ESG rating from an external provider), through to the integration of financially material sustainability data into financial analysis alongside conventional balance sheet and cash-flow metrics, engagement and stewardship of investments through direct engagement and voting, through to sustainability-themed investing, impact investing. These are not variations of the same thing. They involve different data, different processes, different objectives, and critically, different relationships to financial returns.

Arguments against "ESG investing" routinely collapse this entire spectrum of responsible investment practices into a single investment approach with common data, common processes, common objectives and a common concessionary approach to financial returns.

## "ESG" Is Far More Than Screening

The anti-ESG argument's most frequent misunderstanding is between ESG integration and exclusions, they are not the same thing.

ESG integration is the practice most serious institutional investors mean when they speak of incorporating ESG into investment decisions. This involves using financially material sustainability-related data as additional inputs into financial analysis to assess exposure to and management of financially material topics to that specific investment. Carbon emissions data matters to an investor in a carbon-intensive sector because it speaks to future regulatory and litigation risk, and to capital expenditure requirements as energy transition policy tightens. Labour relations data matter to knowledge-based companies because high staff turnover impacts their ability to operate. Physical climate risk matters to real estate assets as floods, wildfires or other changes in climate impact insurance costs and potentially impair assets. Governance data around board independence, executive pay structures, audit quality matters because it speaks directly to the probability of capital misallocation and fraud.

None of this is ideological. It is the disciplined application of a wider information set to the task of understanding the fundamentals of an investment and identifying financial risk and opportunity. An investor who ignores material information is a less informed one.

Screening on the other hand can be excluding investments to limit risk or align with ethics or values, it can also be actively selecting investments primarily based on their sustainability characteristics often with limited consideration of the financial impact.

What the anti-ESG movement does engage with, frequently and with legitimate force, is the imposition of values-based exclusions and ideological commitments onto portfolios without the informed consent of investors. But they are arguments for better governance of responsible investment, greater transparency, and stronger informed-consent architecture. They are not arguments against the use of material sustainability data to support better informed investment decisions.

## The Selective Performance Argument

The comparison of clean energy ETFs to Oil & Gas indices over recent years, a point made by many looking to debunk “ESG investing”. The numbers are real and the comparison is striking. But as a demonstration that “ESG underperforms”, it has serious methodological problems.

It compares a narrow thematic fund (clean energy only) to a sector index (oil and gas only) over a period that was particularly volatile for the energy sector. This is not evidence that all approaches to responsible investment lead to underperformance. Most investment strategies that integrate ESG information into investment underwriting and asset ownership are not sector specific. They are diversified portfolios that use a range of data to inform security selection across all sectors, including energy. Conflating a thematic clean energy or other “ESG” sector product with the integration of financially material ESG information is precisely the label problem we identified in 2021.

As the Prosperity Institute’s paper states “Basic investment principles dictate that when you select investments for reasons other than the fundamentals of the business you will undermine long term performance.” That argument is exactly what led to the integration of material sustainability information within investment processes. Investors could see that sustainability information helped assess the fundamentals of a business. Information that had historically been decoupled from traditional financial information. Those investors that can best combine these complementary information sources to price holistic views of risk and opportunity can understand the fundamentals of investments better and come out on top.

## A Dose of Reality

The responsible investment industry has problems to answer for. Greenwashing is real, as asset managers look to capture investor mandates. The gap between sustainability rhetoric and portfolio reality is often large.

It would be dishonest not to acknowledge what critics gets right. The concern that many savers are invested in “sustainability-oriented” default funds without meaningful understanding or informed consent. The concern that some ESG reporting has become a compliance exercise that obscures rather than supports financial performance, a widely shared view within the responsible investment industry itself. The observation that proxy voting has been partly captured by third-party advisers applying rigid templates is a genuine governance problem.

## What a Serious Response Looks Like

The response to these issues is not to discard the concept of using material sustainability information in investment analysis. It is to demonstrate that through greater precision about what responsible investment means in practice, greater transparency about what each fund actually does, informed identification of financially material topics and relevant data to assess their management, stronger financial outcomes linked to stewardship activities, and strong consent architecture so that investors understand what they are buying. Ultimately this comes down to better governance of investment practices, including responsible investment practices.

In 2021 we argued that “ESG” had become too broad a label to be useful or honest. Five years on, the debate has become even more polarised, and the label has become a political battleground rather than a technical descriptor. The debate will only become more productive when we start to be more transparent about what specific practices are implemented and how these support investment outcomes.

Not looking at material sustainability risks and opportunities is not a more rigorous approach to fiduciary duty, it is a less informed approach. Investors who are willing to be less informed, for the sake of ideology, should be prepared to explain why.

### About NorthPeak Advisory

At NorthPeak we support asset managers and corporates focus on sustainability topics that matter. Those that matter to their investment process, to support their understanding of a particular investments risk or opportunities, so that they can invest more confidently understanding the issues that they are exposed to. For corporates the topics that matter are those that are going to help them as a business reduce operational inefficiencies, strengthen resilience and support growth of both the business and capital provision.

NorthPeak brings together experience in investment management, sustainability strategy with a proprietary technology solution ([Advanced Sustainability Accounting Platform](#)) that enables the identification of material sustainability topics and consistent data collection, supporting the development of sustainability practices that are critical for robust responsible investment and corporate sustainability strategies.

For further information on how NorthPeak Advisory can help you develop your Responsible Investment and Corporate Sustainability approach and beyond, please reach out to [info@northpeakadvisory.com](mailto:info@northpeakadvisory.com).