ESG and Fiduciary Duties for Asset Managers and Pension Fund Trustees

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To discharge their fiduciary duties, asset managers, pension fund trustees and other institutional investors in the United Kingdom and the European Union (the "EU") are permitted and in some cases required to take account of environmental, social and corporate governance ("ESG") factors when making investment decisions.

This Debevoise In Depth examines the fiduciary duties owed by asset managers and pension fund trustees, how ESG considerations relate to those duties, and the risk of any challenge arising to the approach taken by the fiduciary. ESG considerations are broad, encompassing a wide range of factors, often over a long time horizon. ESG considerations involve assessments of both scientific and human rights-related topics, requiring a high degree of judgement as to their relative importance and impact.

What are the fiduciary duties of asset managers and pension scheme trustees?

A fiduciary acts on behalf of another person in circumstances which give rise to a relationship of trust and confidence. These duties can vary, depending on the nature of the relationship, but typically include loyalty, acting in good faith and avoiding conflicts of interest.

In the context of asset managers, fiduciary duties are acting in the interests of beneficial owners, with prudence in handling money, and with care and transparency in managing conflicts of interest. An asset manager's duty of care, that is, to act with the skill, diligence and prudence expected of a responsible asset manager, is also part of its fiduciary duty. The Financial Conduct Authority (the "FCA") in the United Kingdom has not defined an asset manager's fiduciary duty and instead relies on the standard of "acting in the best interests of a client". Similarly, the EU MiFID framework requires firms to act honestly, fairly and professionally in accordance with the best interests of their clients when providing investment services.

Pension scheme trustees owe duties to the beneficiaries of their schemes. Their core fiduciary duty is to promote the purpose of the trust and to use their powers under the

trust documents for a "proper purpose". This sits alongside a statutory duty of skill and care, and, in the context of investment decisions, a duty defined by long-standing case law to invest in the members' best financial interests.

The fiduciary duty of company directors is defined under the UK Companies Act (the "Act"). Under the Act, a director's fiduciary duty is, among other things, to promote a company's success, to exercise independent judgement, reasonable care, skill and diligence, and to deal with conflicts of interests. In promoting a company's success, there is a non-exhaustive list of relevant considerations, including the impact of the company's operations on the community and the environment.

Does the law require asset managers and pension scheme trustees to take into account ESG matters?

The EU Sustainable Finance Disclosure Regulation (the "SFDR") is a framework for managers to disclose, in clear and concrete terms, the environmental and social characteristics of their investments and how they promote principles of good corporate governance. The SFDR requires firms based in the EU or which offer products to EEA investors to describe "the manner in which sustainability risks are integrated into investment decisions" and "the results of the assessment of the likely impacts of sustainability risk on the returns of [their] financial products". For this purpose, "sustainability risks" are environmental, social or governance events or conditions that, if they occur, could cause an actual or potential material negative impact on the value of the investment. In its 2025 report on its "Common Supervisory Action" on the SFDR, the European Securities and Markets Authority considered that the disclosure requirement means that all managers should have in place policies and procedures on due diligence to take account of sustainability risks, with firms' management, compliance functions and audit functions incorporating sustainability risks, with related management reporting.

The SFDR also requires firms to publish information on how they consider, for all their strategies, the principal adverse impacts of investment decisions on sustainability factors, which primarily involves the firm reporting on aggregate "principal adverse impacts" caused by their investee companies, and steps taken to address those impacts, by reference to key data points such as greenhouse gas ("GHG") emissions—with smaller asset managers that have under 500 employees able to opt out. Under the SFDR, it is clear that "principal adverse impacts" are social and environmental impacts—negative externalities. The reporting requirement in the SFDR does not require firms to address social and environmental impacts, as firms can indicate that they have not taken any actions, for instance, to reduce the GHG emissions of their investee companies.

Although the SFDR is largely a disclosure framework, it requires managers to disclose both "sustainability risks" and "principal adverse impacts", with, for those firms in scope of the disclosures, no relief available if the firm does not, as a matter of practice, incorporate sustainability risks or consider principal adverse impacts in its investment decisions. Whilst the framework is not directed at ensuring that managers take into account ESG topics as part of their fiduciary duties, the requirement to make these disclosures is designed to influence a firm's approaches in this area. Under the European Commission's SFDR 2.0 proposal, released in November 2025, firms will no longer have to report aggregate, firm-level principal adverse impacts, although the foundation requirement for all firms to disclose sustainability risks will remain.

Historically, the duty of UK pension scheme trustees to invest "so as to yield the best return for the beneficiaries, judged in relation to the risks of the investments in question"[1] has been narrowly interpreted to exclude the consideration of non-financial factors, including social and ethical factors. However, two UK Law Commission Reports concluded that ESG factors can be financial, such as where they impact a company's long-term sustainability, and since 2019, trustees' statements of investment principles, which set out their investment strategy, objectives and policies, are expressly required to cover financially material factors, including environmental, social and governance considerations and climate change, over the appropriate time horizon of the investments.

As currently understood, the fiduciary duty for asset managers and pension fund trustees is best expressed as a duty to identify financially material factors, including ESG matters, and take these into account in developing an investment strategy which appropriately balances risk and return.

How do fiduciaries incorporate ESG in their decision-making?

Investors are increasingly aware of the environmental and social impacts of their investee companies' activities, including in overseas supply chains, with more data available in many fields. In the United Kingdom and EU, it is largely uncontroversial that fiduciaries take into account ESG factors in their decision-making. Investment approaches which take into account ESG factors are consistent with the fiduciary duties of investors, to the extent that ESG factors relate to the long-term value of their

[1] Based on the decision in *Cowan v Scargill* [1985] Ch 870.

investments, including by reducing risk, improving a company's resilience and generating financial returns.[2]

As above, the EU's requirement for asset managers to disclose how they consider the impact of sustainability risks on returns underlines the expectation that almost all managers take such risks into account as part of their fiduciary duties. However, fiduciaries have very broad discretion as to the manner in which they take into account ESG factors, with key differences between, on the one hand, incorporating ESG into investment due diligence—where managers take different approaches as to the ESG risks identified—and, on the other hand, adopting a "thematic" investment strategy to pursue particular ESG goals.

As above, UK pension scheme trustees, when determining their investment strategy, are required to consider whether ESG factors are financially material for the purposes of their schemes. Defining the circumstances in which ESG considerations are financially material has been the subject of recent debate. In 2024, the Financial Markets Law Committee (the "FMLC") observed[3] that the definition of financial factors is broad, and many factors which may first appear to be non-financial are in fact financial when properly understood. It further noted that "taking sustainability into consideration may reveal new understandings of unrewarded or unmanaged risks or illuminate true return". While the FMLC paper does not have binding legal force, it articulates an argument that ESG factors can and should in some circumstances be part of trustees' investment decisions.

Parliamentary debate relating to the Pension Schemes Bill (now the Pension Schemes Act 2026, which received Royal Assent on 29 April 2026) covered similar ground. Initial proposals for the introduction of a statutory duty on trustees to have regard to systemic risks, including climate change, were rejected, and the House of Lords in early 2026 rejected a proposal to include in the Pensions Schemes Act a requirement for the government to produce statutory guidance on the clarification of fiduciary duties in relation to such risks, with the Lords noting that "decisions about whether to invest, divest or engage must rest with trustees who are already legally required to invest in the best financial interests and to consider climate-related risks as part of that duty".[4] Nonetheless, a Technical Working Group on fiduciary duty (originally convened by the

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2 The UNEP FI "Fiduciary Duty in the 21st Century", a collaborative project in 2019 among PRI, UNEP FI and the UN Global Compact stated that "Failing to consider all long-term investment value drivers, including ESG issues, is a failure of fiduciary duty."

3 Paper: Pension Fund Trustees and Fiduciary Duties—Decision-making in the context of Sustainability and the subject of Climate Change.

4 HL Deb, 23 February 2026, Pension Schemes Bill [HL], Report Stage (Baroness Sherlock). Available at: https://hansard.parliament.uk/Lords/2026-02-23/debates/7AB6B018-AE4C-47BC-9111-84E22C812E30/PensionSchemesBill.

Department for Work and Pensions in March 2026) appears to be moving forward with the development of new guidance for trustees on their investment duties. Although this guidance will not have a statutory basis, it is expected to carry significant persuasive weight.

Fiduciaries are not expected to have perfect foresight. They are free to take into account ESG matters that are reasonably linked to the long-term risks posed by a company in a particular sector, regardless of the different views, including political positions, taken by various groups. There is no current practice in the EU for investors to challenge fiduciaries to prove a close correlation between, on the one hand, the consideration of sustainability, and, on the other, sound risk management and increased value in the portfolio. This reflects a respect for the breadth of discretion that an EU or UK fiduciary is considered to have. ESG-based collaborations between investors are in some cases recognised in EU and UK legislation dealing with fair competition, with authorities in both jurisdictions offering specific exemptions.

May beneficiaries bring a claim for breach of fiduciary duties?

There is limited scope in English law for shareholders to bring "derivative" claims against a company's board of directors for breach of fiduciary duty, reflecting that courts are unwilling to interfere with good faith business judgements.

In 2023, ClientEarth, an active climate lobbyist, brought a well-publicised claim in the English High Court against Shell Plc's board of directors for failure to properly address the risks of climate change,[5] alleging breach of fiduciary and other directors' duties, principally in relation to Shell's climate risk management strategy. The claim was dismissed, as ClientEarth had failed to establish a *prima facie* case that the directors were in statutory breach, mainly because the court was unwilling to impose specific duties on the directors in relation to climate, which undermined the directors' duty to have regard to the company's general success for the benefit of the members as a whole, which involved many competing considerations. The court regarded the manner in which Shell's directors approached climate risk management as a "a classic management decision" which the court was not well-equipped to interfere with.

In *McGaughey v Universities Superannuation Scheme Limited*, the Court of Appeal upheld the High Court's decision to refuse permission for a derivative claim to be brought by members of a pension fund on behalf of the corporate trustee of the fund against its current and former directors.[6] The claimants argued, amongst other claims, that the

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5 *ClientEarth v Shell PLC and others* [2023] EWHC 1897 (Ch).

6 *McGaughey & Anor v Universities Superannuation Scheme Ltd & Ors* [2023] EWCA Civ 873.

scheme's continued investment in fossil fuels was a breach of the directors' fiduciary duties, particularly in light of the scheme's ambition to be carbon neutral by 2050. The court held that there was no actionable derivative claim, in part because there was no evidence that the trustee had suffered loss to the pension scheme arising from its continued investment in fossil fuels.

These cases demonstrate the courts' reluctance both to hold companies accountable for climate-related harms and to influence company policy. Absent clear evidence of bad faith or fraud on the part of the directors, the courts are unlikely to favour the opinions of claimant shareholders in place of directors' day-to-day judgement. Investors in a private fund which disagree with the manner in which the fund's manager has pursued ESG considerations would likewise find any such claim difficult, not only by virtue of procedural challenges in bringing a claim against the fund's investment manager, with whom the investor has no contractual relationship, but also because of an unwillingness by English courts to undermine or challenge reasonable decisions made by fiduciaries.

Is ESG a key part of the mandates of investors?

Many institutional investors incorporate ESG criteria in their investment strategies. This is reflected in different ways in terms that investors may agree with asset managers—often in "side letters" negotiated with the asset manager. In some cases, investors ask for broad commitments from the asset manager to incorporate ESG considerations into their decision-making. In addition, investors often request data from the asset manager on sustainability topics, in particular data on GHG emissions. Many investors are themselves required to adopt a policy on climate change, and to collect related data at the level of their investments. Investors are free to specify particular ESG concerns, such as exclusions for particular types of investments, that they require a manager to incorporate in its investment approach. Investor mandates relating to ESG will often overlap with the commitments the asset manager itself has made in its policies and fund documents, such as in a manager's environmental and social characteristics or sustainable investment commitments under the fund's Article 8 or 9 SFDR designations, although managers regularly accept the incorporation of specific investor ESG concerns as being in line with their fiduciary duty. However, any qualification of the manager's fiduciary duty—such as to select investments with overriding considerations of social impact—needs the approval of all investors.

May fiduciaries incorporate moral, political or similar considerations?

As a matter of practice, many fiduciaries, and most asset managers and pension fund trustees, will not incorporate moral considerations in their investment strategy, unless they have a clear mandate to do so. Whilst the adoption of policies by asset managers that exclude investment in certain sectors, such as tobacco, is generally justified on risk and reputational grounds, few asset managers aside from those with dedicated impact-focused strategies incorporate broader moral or political considerations in their decision-making.

The conventional view in the United Kingdom and EU is that, absent a clear mandate to incorporate ethical considerations which is approved by all beneficiaries, fiduciaries that explicitly consider moral or political factors in their investment decisions are unlikely to be regarded as acting in their beneficiaries' best interests, which are typically financial in nature—at least where a beneficiary can prove that the investment made for moral factors was less beneficial than another investment. Mandates that expressly take into account moral or political factors are rare.

For UK pension scheme trustees, it is generally accepted that non-financial factors should only be taken into account where two conditions are met: firstly, that the trustees have good reason to think that the beneficiaries would share the concern; and secondly, that the decision should not involve a risk of significant financial detriment to the fund.

It is hard to argue that investors which require their asset managers to consider, for instance, the existence of child labour in their supply chains do not do so from strong moral considerations, although arguably the illegality of child labour in almost all countries, and consequential financial and reputational risks involved, is the overriding consideration for a fiduciary.

Is there a code of best practice for the incorporation of sustainability by fiduciaries?

There are a number of frameworks and sources of guidance for fiduciaries to incorporate sustainability considerations into their investment decisions. Many investors and asset managers are signatories to the United Nations Principles for Responsible Investment ("UN PRI"), committing to six core principles on the link between sustainability considerations and investment performance and reporting annually on its sustainable investing activities (see our separate Debevoise In Depth). These principles include incorporating ESG issues into the signatory's investment analysis, decision-making process and ownership policies and practices, as well as seeking appropriate reporting on

ESG issues by investee entities. The UN PRI has published guidance on Stewardship in Private Equity, including how general partners may engage with investee companies, including incorporating ESG-related terms in deal documents and agreeing priority ESG goals, based on considerations such as revenue, the company's peers, costs, and profitability and valuation. The Net Zero Asset Managers Initiative, relaunched in February 2026, is another voluntary initiative for asset managers to make public disclosures to demonstrate how they address climate-related financial risks and respond to opportunities presented by the green transition for both their clients and beneficiaries.

Of relevance to public market investors, the UK Stewardship Code 2020 (the "Code") is a voluntary framework which fiduciaries can adopt to inform their stewardship policies. The Code defines stewardship as the responsible allocation, management and oversight of capital to create long-term sustainable value for clients and beneficiaries.

Other voluntary frameworks which fiduciaries can adopt include the Net Zero Investment Framework, published by the Institutional Investors Group on Climate Change ("IIGCC"), to assist investors in setting targets and producing net zero strategies and transition plans for their portfolios. The ESG Due Diligence Guide published by Invest Europe, includes guidance on how asset managers can integrate ESG factors into their investment decision-making and management process, including by supporting ESG considerations in their portfolio company operations, monitoring and reporting processes.

UK pension scheme trustees in particular should look out for further developments on the clarification of their duties at the intersection of investment performance and ESG. Although the Pension Schemes Act 2026 did not include a statutory basis for fiduciary duty guidance, the output expected from the government's Technical Working Group is expected to address how trustees should consider long-term factors including climate change and other systemic risks and may extend to bio-diversity and nature-related financial risks. Following much debate, the Pension Schemes Act 2026 also introduces a reserve power to enable the government to require certain large DC schemes to allocate up to 10% of their default funds to qualifying growth assets (of which up to 5% may be UK-specific), although this power is time-limited, and the Pension Schemes Act expressly preserves the trustees' ability to seek exemption where compliance would be inconsistent with their fiduciary duties. These developments confirm that further commentary on the trustees' investment duties is forthcoming and that the primacy of fiduciary duty remains the governing principle.

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