UNIVERSITY OF GOTHENBURG
SCHOOL OF BUSINESS, ECONOMICS AND LAW

GM1460 Master's Degree Project in Accounting and Financial Management

FIDUCIARY DUTY AND ESG CONSIDERATIONS – ARE THEY COMPATIBLE?

A case study on institutional investors and their commitment to the Net-Zero Asset Owner Alliance

Authors
Jenny Asplund and William Samadzadehaghdam

Graduate School
Supervisor: Conny Overland

Spring 2020

Abstract

As a response to the issues regarding climate change, several organizations and initiatives are founded to tackle them, such as the Net-Zero Asset Owner Alliance (AOA), backed by the United Nations. The explicit goal of the institutional investors in this alliance is to decarbonize their portfolios by 2050. However, these institutional investors are subject to the fiduciary duty to prudently manage the capital of their beneficiaries in the best interest of these. Since this traditionally interpreted as ensuring or maximizing a high financial return, the problem arises whether the goal of this alliance is compatible with the fiduciary duty of the members. Through an interview case study of the members in the AOA, the process and motivations of how institutional investors work with combining their fiduciary duty and ESG considerations are examined and described. There are four main findings to answer this question. *1) Transitioning for real-world impact* through decarbonization and reallocation serve as a risk-managing tool with the ultimate aim of achieving a good long-term return. *2)* Through *United investor action,* uncertainties on ESG methods and targets can be met through developing a common language, thereby mitigating ambiguities on ESG concerns. *3) Implicit and explicit ESG* considerations enable a frictionless inclusion of ESG factors into the investment process, provided that this is not only based on an internal moral agenda. *4)* It is the *Fiduciary responsibility* of investors to include ESG factors since this enables a long-term view and additional climate risk perspective on the financial outcome, and thereby expected by the beneficiaries to be included. Therefore, we suggest a reconceptualization of *Fiduciary duty* into the slightly different *Fiduciary responsibility.* Other institutional investors with ambitions of incorporating ESG factors can seek motivation and guidance in these findings to assess and manage their potential clashes beforehand.

Keywords: SRI, Fiduciary duty, ESG, Institutional investors, Net-Zero Asset Owner Alliance, Shareholder engagement

Table of content

Abstract ..... **i**

Table of content ..... **ii**

1. Introduction **1**

1.1 Problem area 2

1.2 Purpose and research question 4

1.3 Definitions 4

1.3.1 Fiduciary duty 4

1.3.2 Net-Zero Asset Owner Alliance (AOA) 6

1.3.3 Sustainability concepts 6

2. Literature review and theoretical framework **8**

2.1 Literature review 8

2.1.1 Fiduciary duty and ESG commitments 8

2.1.2 Engagement strategies when including ESG considerations 11

2.2 Theoretical framework 13

2.2.1 Institutional isomorphism 13

2.2.2 Reasons and views on CSR 15

3. Methodology **19**

3.1 Research design and preparation 19

3.2 Case description 20

3.3 Data collection 21

3.4 Data analysis 21

3.5. Critical assessment of the method 23

3.5.1 Critical assessment of data analysis method 24

4. Empirical findings **26**

4.1 Fiduciary responsibility 26

4.1.1 Shifting mindsets 27

4.1.2 Long-termism 27
4.1.3 Upside- and downside risk 28
4.1.4 Transparency towards stakeholders 28
4.2 Implicit and explicit ESG 29
4.2.1 ESG - a natural extension 29
4.2.2 ESG integration into the investment process 29
4.3 United investor action 30
4.3.1 Developing common ground 30
4.3.2 Borderless collaboration 30
4.3.3 Capital as power 31
4.4 Transitioning for real-world impact 31
4.4.1 ESG-related challenges and obstacles 32
4.4.2 Multi-level engagement 32
4.4.3 Divestment decisions 33
5. Analysis and discussion 34
5.1 Fiduciary responsibility 34
5.2 Implicit and explicit ESG 36
5.3 United investor action 37
5.4 Transitioning for real-world impact 38
6. Conclusion 40
Appendix 43
References 47

1. Introduction

Five of the ten global risks with the highest likelihood and impact today are all related to environmental crises; Extreme weather events; Failure of climate-change mitigation and adaptation; Natural disasters; Biodiversity loss and ecosystem collapse; and Man-made environmental disasters (World Economic Forum, 2019). Concerning these issues, the United Nations initiated the Principles of Responsible Investments (PRI) in 2006 as a guide for institutional investors when including Environmental, Social and Governance (ESG) factors in their investment decisions (UN PRI, n.d.). Today, PRI has over 2500 signatories[1] (UN PRI, 2020) and according to the Eurosif SRI study, ESG integration as an investment strategy has grown with 123% since 2013 (Eurosif, 2018) indicating a growing awareness and interest for the ESG area. At the 2019 Climate Summit in New York, the United Nations Environment Programme's Finance Initiative (UNEP FI) together with PRI and a handful of major institutional investors[2] jointly initiated the Net-Zero Asset Owner Alliance (henceforth referred to as AOA) to signal united investor action and take environmental and social responsibility (UNEP FI, n.d.). The explicit goal of the members of this alliance is to transform their portfolios into emitting net-zero greenhouse gases (GHG) by 2050 (UNEP FI, n.d.). However, these institutional investors are subject to the fiduciary duty towards the beneficiaries whose capital they are managing. The fiduciary duty articulates the responsibility amongst trustees to prudently manage this capital in the best interest of the beneficiaries, traditionally interpreted as ensuring or maximizing a high financial return. Although these initiatives and actions are all articulated to be for the greater good of society and the environment, they introduce additional considerations into the investment decisions than the solely financial. The problem, therefore, arises if the commitment to this alliance is compatible with the fiduciary duty of meeting target returns and expectations of the beneficiaries, and subsequently how these two aspects are combined. This question has previously been examined theoretically, but not in a practical sense, hence we seek to describe the process of combining the fiduciary duty and ESG considerations through a case study of members of the AOA. The implications of the findings

[1] PRI has 500 asset owners as signatories, but 2000 investment managers due to the requirements of many asset owners (UN PRI, 2020)

[2] AOA refers to the members as "*a group of institutional investors*" (UNEP FI, n.d.). According to Cambridge Dictionary (n.d.) an institutional investor is "*an organization, for example a bank or insurance company, that invests in something*", which can thus also include pension funds, universities and religious organizations. Henceforth, the organizations concerned in this thesis will be referred to as institutional investors.

aim to clarify the ambiguities in the area and could provide guidance for practitioners who consider including ESG factors into their investment decisions.

The remainder of this thesis will be organized as follows: the rest of this section initially presents the problem description and research question followed by some useful and defining information. Section 2 will more thoroughly assess the existing literature and findings in this area and present the theories and frameworks used in the research. In section 3, we outline the methodology behind our research, and in section 4 all the empirical findings are presented. Finally, the analysis and discussion of the empirical findings in relation to the theoretical framework will take place in section 5, to end up in the concluding remarks of section 6.

1.1 Problem area

Some previous studies have discussed the complex and at times paradoxical subject of combining the fiduciary duty with ESG considerations out of theoretical and philosophical perspectives (Sandberg, 2013). Other studies have instead focused on whether or not the beneficiaries' best interests are considered in this process (Jansson, Sandberg, Biel & Gärling, 2014; Richardson, 2011). Furthermore, there have been quantitative approaches to this with the aim to present the effects of shareholder engagement and the inclusion of ESG criteria in the investment process (Hoepner, Rezec & Siegl, 2011; Manning, Braam & Reimsbach, 2018). But to our knowledge there are no explicit empirical investigations on how the practical work with integrating ESG considerations into the investment process is done and motivated. In the traditional way of viewing the fiduciary duty of the institutional investor, a conflict will arise by committing to the AOA to transform the portfolio to net-zero GHG. But what are the critical touching points when combining the two, and how could they even be united? There are arguments both in favor and against the possibilities and importance for institutional investors to engage in SRI and consider ESG when making investment decisions.

An argument for why institutional investors ought to engage in SRI is the significant amount of capital they manage through various assets. Consequently, if ESG factors would be included in their investment decisions, this capital could be utilized in a socially responsible manner with a significant impact on the sustainability actions of portfolio companies (Sandberg, 2011; Hamilton & Eriksson, 2011). Many of the arguments in favor of SRI take on the perspective of pension funds since these institutional investors naturally have beneficiaries with long-term

investment horizons (Jansson et al., 2014; Hoepner et al., 2011). Those arguing in favor of the inclusion of ESG-factors many times refer to the concept of Universal Ownership which suggests a more holistic portfolio-view (Hawley & Williams, 2002; 2007). This, since the potential negative externalities from financially high-performing but polluting companies, might have adverse effects on other portfolio companies (Hawley & Williams, 2002; 2007). However, as institutional investors, with the responsibility of managing the current and future wealth of others, making such decisions must be aligned with the expectations of their beneficiaries and the duty to conform to these.

According to the Freshfield report (2005) it is permissible, or even mandatory, to consider ESG factors under a few circumstances, which will be further presented in section *2.1 Literature review*. Although the report has been celebrated, there has been a call for reassessment and re-interpretation of these conclusions (Jansson et al. 2014; Sandberg 2011; Hoepner et al. 2011; Eurosif, 2018). For example, Sandberg (2011) claims that legal reform is needed as a driving factor for institutional investors to involve ESG considerations strategically in their investment process. Without such reform, institutional investors would risk breaking their formal fiduciary duty towards their beneficiaries regarding acting in the best interest of their beneficiaries. Many scholars and institutional investors claim that an institutional investor's fiduciary duty is met when striving to maximize financial returns, which is argued to be compromised when integrating ESG factors into the investment process (see for example Sandberg, 2011; Hoepner et al., 2011). A more recent study by Schanzenbach and Sitkoff (2019) meant that ESG considerations are permissible concerning the fiduciary duty of pension funds if two conditions are satisfied: firstly, if it is concluded that ESG integration will improve the risk-adjusted return for the beneficiaries and secondly, that the motive of the pension fund is to directly obtain this benefit in favor of their beneficiaries.

Although there are several ESG initiatives like the AOA to which institutional investors have committed, there are still confusion and conflicting arguments regarding whether or not these sorts of commitments are possible while still fulfilling the present fiduciary duty. Conversely, questions arise regarding if the fiduciary duty is eligible to meet the global environmental and social needs.

1.2 Purpose and research question

As discussed in the previous section, there is a widespread ambiguity regarding the possibilities to include ESG considerations while not contradicting the fiduciary duty of institutional investors. And while there is some research on the theoretical possibilities of combining the two, very few empirical studies have been performed to examine this. Hence, we formulate our research question as:

How do institutional investors work with combining their fiduciary duty and ESG considerations?

By examining this, we seek to describe the process of combining the fiduciary duty with ESG considerations through the AOA-commitment. More specifically how it is done and motivated. With this knowledge, other institutional investors with ambitions of incorporating ESG factors, could assess and manage their potential clashes beforehand. Moreover, through providing empirical evidence this thesis will also enrich the academic literature on fiduciary duty and SRI.

1.3 Definitions

Certain concepts and areas are noted to be important to fully understand before continuing reading the thesis. Therefore, a more thorough definition of these follow in the paragraphs below.

1.3.1 Fiduciary duty

The fiduciary[3] duty of institutional investors is comprised by two different parts, where one part is the so-called *duty of loyalty;* that trustees are obligated to manage the capital in the beneficiaries' best interest without incorporating their own self-interests (see for example Hoepner et al., 2011; Sandberg, 2011; 2013; Richardson, 2013; Jansson et al., 2014). The other is the *prudent man rule* which seeks to ensure that the investor exercises care and consideration, makes sufficient research and consults with experts before taking investment-decisions (Sandberg, 2013; Jansson et al., 2014). Although the fiduciary duty per se is only applicable in common law jurisdictions like the US and UK as acknowledged by e.g. Sandberg (2011; 2013)

[3] The word fiduciary stems from the Latin word for *to trust* (Sandberg, 2013)

and Jansson et al. (2014), a somewhat similar set of responsibilities and duties is still accepted and adopted worldwide. In Sweden there is the law on insurance operations (Försäkringsrörelselag (2010:2043)), which all the Swedish organizations in this study abide by. Chapter 6 in this law begins with a paragraph similar to the fiduciary duty stating that if conflicts of interest between the insurance company and the beneficiaries occur, the assets shall be managed in a way which best benefits the interests of the beneficiaries and other people eligible for compensation[4] (Sveriges Riksdag, 2010, 6:1, para. 2). Furthermore, a new law regarding occupational pension companies (Lag (2019:742) om tjänstepensionsföretag) came into effect at the end of 2019. If the fundamental conditions are met and a majority of two-thirds support the transition, an insurance company like the ones included in this study, can transform into an occupational pension company (Sveriges Riksdag, 2019, 2:4-5). Nevertheless, this law also includes a section saying that the assets shall be managed in the way which best serves the interests of the beneficiaries in both the short and long term, and if conflicts of interest occur, the investment decisions should be taken exclusively in the interests of the beneficiaries[5] (Sveriges Riksdag, 2019, 6:2). This together with other laws and regulations, and the Swedish Financial Supervisory Authority (Finansinspektionen), govern the financial institutions of Sweden.

Furthermore, In 2005 UNEP FI assigned the British law-firm Freshfields Bruckhaus Deringer the mission to produce a report with an assessment of the obstacles and possibilities to include ESG-considerations into investment decisions without breaking the fiduciary duty. The common sentiment is that this report, commonly referred to as the Freshfield report, is optimistic about the incorporation of ESG factors and seen as "*...the single most effective document for promoting the integration of environmental, social and governance (ESG) issues into institutional investment.*" (UNEP FI, 2009). However, many scholars indicate that the conclusions in this report are not as positive and straight forward after all (see for example Sandberg, 2011; Schanzenbach & Sitkoff, 2020).

[4] Free translation by the authors

[5] Free translation by the authors

1.3.2 Net-Zero Asset Owner Alliance (AOA)

In connection with the 2019 UN Climate Summit in New York, September 23rd, a group of six large institutional investors assembled by UNEP FI and PRI, agreed to the common goal of transforming their portfolios into emitting net-zero GHG by 2050 to remain below the 1,5°C temperature increase from pre-industrial levels (UNEP FI, n.d.). Since then, thirteen organizations have joined, adding up to 19 global institutional investors committing to this goal through engagements on both corporate and policy level, and enhancing existing investor initiatives with similar missions (The net-zero asset owner alliance, 2019). In a publication by the alliance, the challenge of not overlooking the fiduciary duty of the members is said to be managed by ensuring "*...this Commitment [to] be embedded in a holistic environmental, social and governance (ESG) approach, incorporating but not limited to, climate change, and must emphasize GHG emissions reduction outcomes in the real economy.*" (The net-zero asset owner alliance, 2019, p.5), but without any further instructions on how this is done in practice.

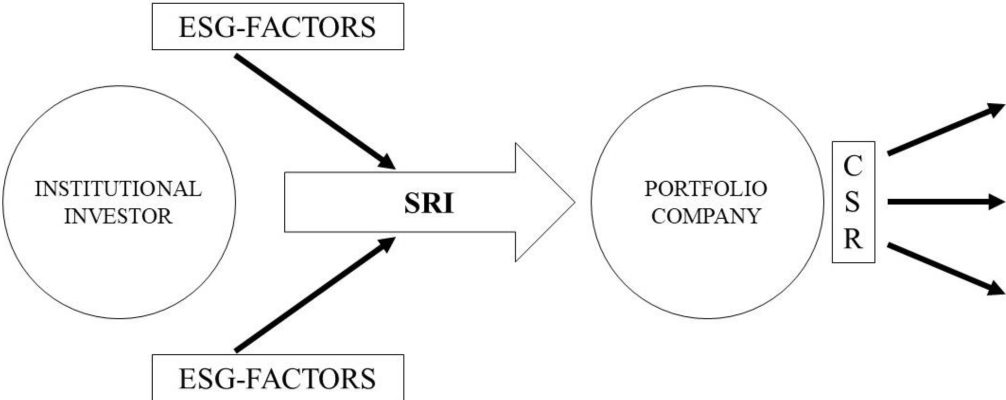
1.3.3 Sustainability concepts

At the 1987 UN General Assembly meeting, chaired by the then Norwegian Prime Minister Gro Harlem Brundtland, the term sustainable development is said to be introduced the first time with the denotation "*...to ensure that it meets the needs of the present without compromising the ability of future generations to meet their own needs*." (UN, 1987, p.24). Today, this has evolved into the 17 Sustainability Development Goals (SDG) developed by the UN, ranging from *Zero Hunger* (#2) and *Affordable and Clean Energy* (#7) to *Climate Action* (#13) and *Partnerships to achieve the Goal* (#17) (SDGs, n.d.).

Regarding sustainability in the domain of institutional investments, the first acknowledged case are the ethical considerations in the investments of religious organizations in the 19th century. Here, the greatest concerns were that morally questionable industries like tobacco and gambling should be excluded from the portfolio (Wen, 2009; Richardson, 2013). Today, this has further developed into the concept of Socially Responsible Investments or Investing, SRI. The main characteristics of SRI are that it combines the traditional financial objective of obtaining a high return with additional factors such as social and environmental goals into the investment decision process, and is usually seen to encompass a more long-term horizon investing philosophy (Clark & Hebb, 2005; Wen, 2009). A common way to refer to these additional factors is ESG, and by including these factors into the SRI performance, the investor seeks to

engage and affect and pressure the portfolio company to address issues within their Corporate Social Responsibility (CSR) (Wen, 2009). These concepts are used widely and sometimes interchangeably which could introduce some ambiguities in the area. However, this section together with *Figure 1* below has sought to clarify and relate these concepts.

Figure 1 - Sustainability concepts within institutional investments



This figure briefly illustrates the relationship between the different concepts occurring within the domain of sustainability in institutional investments. The institutional investor who engages in SRI includes ESG factors to have an impact on the portfolio company and its CSR.

2. Literature review and theoretical framework

2.1 Literature review

This section of the thesis is divided into two parts, where the first will present previous studies regarding the compatibility of fiduciary duty and ESG considerations in the investment process. These rather differing arguments and perspectives mainly surround the concept of Universal Ownership and SRI. The second part will more in-depth cover studies focusing on the practices and strategies of shareholder engagement and divestment when including ESG considerations.

2.1.1 Fiduciary duty and ESG commitments

The fiduciary duty which surrounds institutional investors has generated different, and many times conflicting, implications regarding whether it permits ESG considerations in the investment process. Hawley and Williams (2002; 2007) use the concept of Universal Ownership (UO) to explain why large institutional investors ought to consider the possible negative externalities from their portfolio companies. By adopting the Modern Portfolio Theory, stating that optimal return is obtained through high diversification, these large institutional investors have differentiated their portfolios to the degree that they are indexed over the whole economy, and have become Universal Owners (Hawley & Williams, 2002; 2007; Richardson & Peihani, 2015; Krueger, Sautner & Starks, 2019). Since these owners are subject to the fiduciary duty of loyalty and care towards their beneficiaries, their ability to meet this fiduciary duty will thus depend on negative externalities and disruptions affecting the other portfolio companies' performance. Universal Owners are therefore incentivized to improve the overall macroeconomic well-being to fulfill their fiduciary duty, and for this reason, institutional investors should consider ESG in their investment decision processes. Hawley and Williams (2002; 2007) add emphasis to this by extending the obligations of Universal Owners to also engage in universal monitoring, meaning they must actively identify the positive and negative externalities to further improve long-term performance.

Although agreeing that the Universal Ownership concept is normative and descriptive in how long-term institutional investors should act regarding the inclusion of ESG factors, Richardson and Peihani (2015) firmly state that the concept as such is premature in fully capturing this. The main shortcomings of Universal Ownership are related to measurement since financial markets struggle with understanding the characteristics of the negative externalities and how to measure

and materialize these costs. Moreover, macroeconomic growth is mainly measured through GDP, which neglects the negative effects of social and environmental deficits and damage on financial growth. The second shortcoming of Universal Ownership stands in direct conflict with arguments previously made by Hawley and Williams (2002; 2007) and allege that institutions and companies do not know how e.g. climate change affects their balance sheets and the financial data behind their KPIs (Richardson & Peihani, 2015). Additionally, Universal Owners are accused of neglecting alienated citizens, who might not be able to make their voices heard, which questions whether or not the term *beneficiary*, which Universal Owners aim at serving, really considers all societal members or ESG factors which are affected by their actions. Therefore, Richardson and Peihani (2015) conclude that a reform of the laws surrounding Universal Owners is needed to unveil their full potential and help them coordinate their activities efficiently for the best interest of their beneficiaries.

Other studies take on the perspective of non-ESG compliant companies and the dynamics and traits of their stocks and performance. For example, Hong and Kacperczyk (2009) present evidence that these so-called sin-stocks, including tobacco, gambling and alcohol, provide higher returns than non-sin. In their study, they include institutions like universities, religious organizations and pension funds which impose norm-constraints, and thus exclude these sin-stocks. The financial costs from having such norm-constraints, be it social or environmental, are argued to be derived from the sin-stocks being relatively low-priced, the inability of the investor to fully diversify, and the loss of the possible higher return from the present risks of for example litigation among sin-companies (Hong & Kacperczyk, 2009). Moreover, from a more opportunistic point of view there is a lack of confidence that ESG considerations will add profit to the portfolio companies, although there is no doubt of the positive long-term effects (Wen, 2009). Cai, Jo and Pan (2011) found a positive relationship between the firm value of sinful companies and their engagement in CSR, thus supporting their value-enhancement hypothesis. Furthermore, Clark and Hebb (2005) use the Price-to-Earnings ratio to define corporate value and argue that reputational damage, often regarding CSR related matters, could also affect future stock prices, with effects on the earnings and thus corporate value. Krueger et al. (2019) further present evidence from several studies arguing that long-run climate risks and environmental pollution adversely affect corporate earnings, arguing that climate risk is mispriced in the financial market. The implied cost of capital required by investors is also found

to decrease with an increased level of CSR initiatives among firms from controversial industries, (Hmaittane, Bouslah & M'zali, 2019).

The Freshfield report from 2005 is sometimes referred to as "*...the single most effective document for promoting the integration of environmental, social and governance (ESG) issues into institutional investment.*" (UNEP FI, 2009). It seeks to evaluate the possibilities to include ESG considerations in the investment process from a legal and practical perspective, and contributes to the discussion by making three main arguments. The first argument concludes that it is permissible to include ESG considerations when the financial analysis is completed and the investment opportunities left are equally attractive financially (Freshfields Brunkhouse Deringer, 2005). In those cases, ESG considerations could work as a tie-breaker in favor of the better ESG performer. However, Sandberg (2011) argues that this scenario is too simplified and unrealistic, mainly due to the improbability of finding financially identical investment opportunities, and also to decide on which ESG factors to favor. The second argument of the report suggests that trustees are to consider ESG factors at some level in every decision made if it is linked to improved financial performance and valuations of investment opportunities (Freshfields Brunkhouse Deringer, 2005). Whether or not the supporting evidence is strong enough is debatable, and results of this are not credible enough (Sandberg, 2011). The third argument of the report states that trustees are allowed to include ESG considerations if there is unanimous consent amongst their beneficiaries (Freshfields Brunkhouse Deringer, 2005). The practical feasibility of gathering the preference and stance of each beneficiary comes to question, and there are doubts that all beneficiaries can and will agree upon one single ESG issue (Sandberg, 2011; Richardson, 2011). Jansson et al. (2014) investigated this and concluded that although beneficiaries were positive to including ESG considerations, there was not one single issue that all beneficiaries could agree upon as being the most important. This is further pondered upon by Schanzenbach and Sitkoff (2019) who highlight these conflicts of interests arising from the agency problem as potentially violating the duty of loyalty. Sandberg (2011) concludes that all responsibility for engaging in, and developing, SRI ought not to be put on the institutional investor, but that legal reform is needed to strengthen the importance of SRI and enable institutional investors to engage in it. Similarly, Wen (2009) seeks more unified standards and criteria on how to assess SRI performance.

2.1.2 Engagement strategies when including ESG considerations

Much of the recent literature on SRI highlight the challenge and importance of being an active investor to affect and engage portfolio companies when including ESG considerations into the investment process. The prevalence of such active ownership is shown in the survey study by Krueger et al. (2019), indicating that only 7% of institutional investors report no actions taken on climate risk. The activities and actions are typically divided into *engagement* and *divestment* (UN PRI, n.d; Sjöström, 2020). But in contrast to the view that these two approaches are separate and sequential, with divestment as a consequence of unsuccessful dialogues, Goodman, Louche, van Cranenburgh and Arenas (2014) argue that they are rather intertwined. For example, the threat of exit can be used as an engagement activity, and after divestment the investor can remain engaged but on different terms (Goodman et al., 2014). As shown in the case-study on strategies used by the Swedish National pension funds (AP-funds), media is included as a supporting third-party in the divestment strategy to promote name-and-shame campaigns on blacklisted companies (Hamilton & Eriksson, 2011). However, these tactics might be undermined by the confidentiality of company conversations, and the company-shareholder relationship might experience a potentially negative impact (O'Rourke, 2003).

According to Sjöström (2020), motives behind fossil-fuel divestment can be both non-financial, by wanting to halt climate change and building anti-fossil-fuel norms, and financial, through protecting shareholder value. The rationale behind the latter is that depending on future climate regulation, the assets of these fossil-fuel companies risk becoming stranded i.e. forced to remain in the crust of the Earth, subsequently affecting the share price of these companies (Sjöström, 2020). And although these fossil-divestments can lead to temporary price-effects, especially if initiated on a governmental level, there is no or little evidence on any changes in the level of emissions (Sjöström, 2020), or long-term price effects since the high liquidity of financial markets just transfers the divested ownership to a new investor (Schanzenbach & Sitkoff, 2019). According to Krueger et al. (2019), divesting from fossil-fuel companies is counter-intuitive for institutional investors with climate-positive intentions since "*...divestment would reduce investor influence to improve climate policies.*" (p.27). Furthermore, they find that in considering ESG, divestment is the least used strategy with only 17% of institutional investors divesting when being dissatisfied with company responses (Krueger et al., 2019).

The other alternative to active ownership and practice of including ESG factors is hence the engagement strategy, which institutional investors tend to favor over exclusion and divestment (O'rourke, 2003). According to Goodman et al. (2014), the decision when choosing between voice or exit depends on the judgment if it is worthwhile to remain, and the likelihood of having an impact on the company. Investors who stay as owners and use an engagement strategy can further strengthen their impact by forming coalitions with other investors (Hamilton & Eriksson, 2011). In line with this, Sjöström (2020) shows that these coalitions and platforms like the UN PRI add normative power, legitimacy and infrastructure to the engagement activities by collecting the power and voices of many investors (Sjöström, 2020). Additionally, in determining the success of the engagement activities, legitimacy is found to be an important attribute for the reputation and credibility of the engagement organization, and how the ESG considerations are presented (Sjöström, 2020; Gifford, 2010). For example in the company dialogue, it is important to present and emphasize SRI through a strong business case, or raise awareness by providing new information on emerging issues (Sjöström, 2020; Richardson, 2013). In the case of dialogues, these can be reactive and incident-based or proactive (Sjöström, 2020). Other ways of including ESG factors through engagement are to file shareholder resolutions, participate in voting, or take on public confrontation with the help of for example activist organizations (Goodman et al., 2014; Wen, 2009).

According to Krueger et al. (2019), most institutional investors prefer to initially engage through private negotiations and dialogues and take public actions when these behind-the-scenes attempts have failed. Regarding shareholder resolutions, these are used in various ways - they can be a means to attract management attention to a certain issue, or as the last resort when other strategies have failed (Goodman et al., 2014; Richardson & Peihani, 2015). Moreover, withdrawal of resolutions can be considered either as a failure (Goodman et al., 2014) or as a success since this usually means that management has entered into dialogue with the responsible investors or agreed to handle the issue raised (Sjöström, 2020). As with many activities with dispersed participation, the collective action problem is present as it allows other, less engaged, investors to partake in the outcomes from the endeavors of large active investors which bear the monitoring cost. Wen (2009) accuses this free-rider problem to be one of the obstacles to SRI. This is further agreed upon by Schanzenbach and Sitkoff (2019) who refer to UN PRI when calling out the free-rider issue to "*...plague active shareholding*." (p.47). Regarding the effect of stakeholder engagement and board monitoring on portfolio companies'

level of sustainability reporting, Manning et al. (2018) found that this has short-term positive effects on a company's sustainable reporting quality and its level of compliance to sustainability reporting standards. However, the effect on the sustainability performance of these firms was not proven significant in the short term, but positively related to stakeholder engagement in the long term (Manning et al., 2018). Another long-term effect of shareholder engagement, although more subtle, is that it creates an awareness of responsible ownership which might alter the attitudes on these issues (O'Rourke, 2003).

2.2 Theoretical framework

This research takes on an inductive approach. This means that we first gathered data and packaged the empirical findings and then searched for relevant theories to help us describe phenomenons, concepts, and eventually answer our research question. In this section, we present the two theories used in the analysis of the empirical findings. The section will be concluded with a summarizing table on these theoretical concepts and points.

2.2.1 Institutional isomorphism

The core of the issue at hand is how institutional investors work when combining the fiduciary duty of trustees - often equated with obtaining high returns - and a commitment to SRI and thus the inclusion of other societal factors than the solely financial. The shareholder view, with its focus on high returns, is derived from the neo-economical way of perceiving the company, and usually opposed to the stakeholder view, which takes other stakeholder groups such as employees and society into consideration as well. A theory that tries to explain this sort of opposing forces is the theory of institutional logics, or as in this particular thesis, when two competing institutional logics are present in an institutional field. Thornton (2004, p.69) defines an institutional logic as a "*...socially constructed, historical pattern of material practices, assumptions, values, beliefs, and rules by which individuals produce and reproduce their material subsistence, organize time and space, and provide meaning to their social reality.*".

In the case of this thesis, where the research question aims to investigate what institutional investors do to combine the fiduciary duty with ESG considerations, it is interesting to examine the dynamics and forces that surround the institutional investors and how it might affect their strategies and perceptions regarding ESG. In regard to this, the following section presents

DiMaggio and Powell's (1983) theory of *institutional isomorphism,* which explains how initially diverse corporations in a certain organizational field eventually become more like one another. The organizational field is used as the outer boundary of analysis as this encompasses not just the industry in which organizations operate, but also the regulatory agencies, key suppliers and consumers related to this industry. Asset owners, asset managers, beneficiaries, policymakers and legislative organs are all part of the same organizational field which surrounds the practice of institutional investments. Institutional isomorphism will come in handy when examining the attitudes towards ESG and if the previously niched area of SRI is getting institutionalized into the organizational field, or if the fiduciary duty cannot approve such inclusion of non-financial aspects into the investment process. Have the early adopters with the aim to improve performance been replaced with organizations seeking legitimacy through adoption?

Besides the competitive isomorphism suitable in markets with open competition, DiMaggio and Powell (1983) present three different types of institutional isomorphism, which are more appropriate for the modern world: *coercive, mimetic* and *normative*. *Coercive* isomorphism regards both political influence and legitimacy problems that can arise from both informal pressures, such as cultural expectations, or formal pressures in the form of legal requirements, rules and government mandates. Eventually, these institutionalized rules will be reflected in the organizational structures, sometimes rather ceremonially, and provide rituals around which the organizations can gather. Such isomorphism can be deemed as a "*...force, as persuasion, or as invitations to join in collusion.*" (p.150). Moreover, the more implicit coercive isomorphism is generated from the strive to gain legitimacy by for example developing organizational hierarchies and structures. The second source of institutional isomorphism is the *mimetic*, which is mostly generated through the force of uncertainty. DiMaggio and Powell (1983) suggest that times of poorly defined goals and ambiguities invite smaller organizations to imitate and model upon powerful and influential organizations in the organizational field which have more experience or success, or are otherwise perceived as more legitimate. This modeling might even be against the modeled organization's will or knowledge, and can occur indirectly through employee turnover and the mobility of acquired know-how, or explicitly through the development and transfer of organizational strategies and models. The final isomorphic force, *normative isomorphism*, comes from the desire of members in an organizational field to define and establish legitimacy for their occupancy, also referred to as professionalization.

Professionalization entails two dimensions with isomorphic influence, of which formal education is one and the development of professional networks is another. The selection of personnel, especially to executive roles, often includes promotion of a certain role, specific requirements on education or experience, or even certain personal characteristics, leading to a homogeneous group of people in these positions and commonly acceptable career paths. If perceived to be different from this group, the practice of socialization will ensure the individual to adapt to the framework. Moreover, in sectors lacking legal barriers for collusion, leading managers of central organizations might also sit in boards and panels which decide on grants, etc., further reinforcing the power and ideal form of this role.

2.2.2 Reasons and views on CSR

There are several rationales and ways of how to perceive and work with CSR. This section will present the paper by Bénabou and Tirole (2010), where they discuss different reasons and views on CSR. Textbook economic views favor a shareholder-value approach and suggest that shareholders with profit-maximizing motives should control companies. In addition to this, the state is perceived as responsible to correct economic damages due to externalities. At the same time, institutional investors are experiencing increasing external pressure from society and lawmakers to take social and environmental responsibility. Some of the main factors behind this are that institutional investors are in a good position and able to help failing markets, social and environmental issues. This is very much related to the core concept of CSR[6] which explicates that institutional investors[7] should sacrifice profits to contribute to the greater good of the society, including when faced with negative externalities. To take corporate social responsibility, there is a range of behaviors that are embraced and that calls for duties that might stand outside institutional investors' immediate scope of activities and investment considerations. And even if it might seem evident to many institutional investors to act on these issues, it is not as clear how and if it helps to fulfill their fiduciary duty, and by that their main responsibility towards their beneficiaries. Therefore, it is worth exploring the concept of CSR to understand the motivations and understandings of *why* institutional investors engage in CSR.

[6] For further definitions see *1.1.3 Sustainability Concepts*

[7] Bénabou and Tirole (2010) write "companies" whereas we have used "institutional investors"

Out of a general view, good-cause activities are increasing and are explained to be powered by several reasons. One is that it could become a *normal good* in the future, and related to this is the second reason that *sharing and accessing information* is easier, hence the practices and reporting become more visible to the external view. The third reason is the *increase in negative externalities* from global companies' operations outsourced to less developed countries. The fourth reason is that *long-term costs* of climate change externalities have significantly increased, as has the public attention regarding this. When narrowing the scope, there are different motivations and understandings of the concept of CSR amongst institutional investors, which in turn also affect the share of responsibility taken. One motivation is skepticism regarding the ability of governments to handle these issues efficiently and sufficiently. Governments could become captured by lobbyists and large groups of interests which could affect the outcome. They are also often hindered and slowed down by territorial and jurisdictional reasons. Because of this, governments might lack the direct power of affecting cross-border issues. Thus, harsh methods such as investor activisms and consumer boycotts might be used. High transaction costs and inefficiencies in sharing and delivering information could make governments disadvantageous in resolving less visible issues such as poor handling of employees or likewise. Conflicting values of lawmakers and economic agents present the second motivation. Policies cannot reflect all preferences of investors, hence inducing institutions and companies to become activists.

Furthermore, Bénabou and Tirole (2010) present three different but somewhat intertwined views and understandings of CSR. The first one is that engaging in CSR will introduce a *win-win* situation. This can subsequently be reformulated as *doing well by doing good* when engaging in social and environmental issues, thereby lowering the legal and regulatory risks from environmental pollution and social wrongdoing. This view favors a long-term perspective since "*...short-termism often implies both an intertemporal loss of profit and externality on stakeholders.*" (p.10). Monetary incentives and the desire to remain and climb the career ladder are both argued to be reasons amongst managers to sustain a short-sighted horizon. The second view presents the notion of *delegated philanthropy* and suggests that some stakeholders have a private moral agenda they wish corporations would engage in on their behalf. Due to information and transaction costs, corporations are better off managing their externalities than if stakeholders would start mapping out the value chain, investigating the affected areas and find charitable organizations to have an impact themselves. Moreover, without explicit

regulations in place, delegated philanthropy is a way of keeping away from actions with adverse effects. The downside of this is, however, the risk of greenwashing, where responsible activities are undertaken to conceal fraudulent businesses. The third and final view of CSR is the *insider-initiated corporate philanthropy*, which is somewhat similar to the second vision, only that it is derived from inside the organization itself and the morals and preferences of top management or board members. This stands in direct relation to the argument presented by Milton Friedman that corporations ought not to use the shareholders' money to fulfill charitable causes (see Bénabou & Tirole, 2010). Out of the three views presented, this will most probably contradict with profit maximization and create problems with corporate governance. This paper presents background, reasons and views on how socially responsible behavior among corporations is conveyed and is therefore utilized as a reference when assessing the ESG considerations taken by the case organizations.

Table 1 - Summary of theoretical concepts

INSTITUTIONAL ISOMORPHISM	
THEORETICAL CONCEPT	DEFINITION
Coercive isomorphism	- Formal or informal rules and pressures towards similarity (isomorphism) - Legitimacy concerns when striving to become alike
Mimetic isomorphism	- Isomorphism powered by uncertainty - Powerful and influential organizations are modeled upon for inspiration
Normative isomorphism	- Professionalization to define and establish legitimacy for an occupancy - Two dimensions: Formal education and development of professional networks
REASONS AND VIEWS ON CSR	
Normal good	- With increased wealth and awareness, the demand for CSR increases
Sharing and accessing information	- It is becoming easier to share and access information. - Practices and reporting become more visible to the external view
Negative externalities	- Increased negative externalities form globalization and outsourcing
Long-term costs	- LT costs of climate change externalities have significantly increased
Win-win situation	- Doing well by doing good - Lowering of risk when engaging in social and environmental issues
Delegated philanthropy	- Customers expect the companies to engage in CSR on their behalf - More efficient for companies to do this due to transaction costs
Insider-initiated corporate philanthropy	- Top management's own preferences dictate what, and if, CSR activities are included in the operations

This table summarizes the theoretical concepts and points from the theories presented in the section above. This framework will later be used in 5. Analysis and discussion *when put in relation to the empirical material collected through the interviews and presented in* 4. Empirical findings.

3. Methodology

To answer the research question, we will conduct an inductive comparative case study with multiple units of analysis, which is a part of practice-oriented research design. The following section will explain this approach further and present some arguments for its suitability concerning the formulated research question. Furthermore, we will present the process for data collection and analysis and conclude with a discussion where the method is critically assessed.

3.1 Research design and preparation

This thesis takes on a practice-oriented research design meaning that our main objective is to contribute to the knowledge of practitioners, which in this thesis are the institutional investors (Dul & Hak, 2008). It is primarily based on the assumption that these practitioners need more knowledge on how to clarify and approach a specific problem within their unaltered reality, i.e. how to combine their fiduciary duty with ESG considerations (Dul & Hak, 2008). To understand this reality, we conduct a comparative case study, meaning that we obtain data from several instances, which in this thesis are the seven different organizations further presented below, to achieve our research objective. This design will allow us to focus on this commitment as one case, understand the dynamics, get a real-world perspective on the organizational processes and target the how and why questions (Yin, 2014; Eisenhardt, 1989).

During the process of formulating a specific problem and research question, the area surrounding institutional investors and their impact on sustainability was found as very interesting. A thorough literature review was conducted, and the scope was narrowed down to the research area touching upon the fiduciary duty in combination with SRI. The relevant articles and studies included in this thesis were found through Google Scholar and the library database at the School of Business, Economics and Law at the University of Gothenburg. The main keywords used were shareholder engagement, ESG, universal ownership, sustainable investments. During the process of refining the problem area and research question, we met with two researchers in the area (Dr. Emma Sjöström and professor Joakim Sandberg), who gave us input on what relevant issues they currently are looking into. Moreover, they provided feedback on our research question regarding examining the process of combining ESG considerations with the fiduciary duty in relation to the AOA. Hence confirming the relevance of this issue. Furthermore, after a profound preparation and exploration of practice and theory,

we did not find a clear hypothesis to test, thus our practice-oriented research objective is of a descriptive research type (Dul & Hak, 2008). As previously mentioned, we instead aim on describing *why* and *how* the included practitioners understand the dynamics and responsibilities within their context of institutional investments (Yin, 2014; Eisenhardt, 1989). To learn more and better understand this we will look into relevant cases where the identified issue of this research arises, namely the cases of the different AOA member organizations included. In the analysis we will identify, describe and compare the different findings obtained through the interviews and develop a conceptual framework. Dul and Hak (2008) argue that single case studies are suitable for hypothesis-testing studies, while descriptive studies are best conducted through a comparative approach. Hence, the most eligible method to use to achieve the purpose of this thesis is the comparative case study approach (Dul & Hak, 2008).

3.2 Case description

The case which will represent the combination of the fiduciary duty and ESG considerations is the recently formed Asset Owner Alliance and the activities of a number of the members when committing to this alliance. The main distinction between asset owners and asset managers is that the former are the legal owners of the assets. They decide on where to allocate the assets based on certain investment objectives, and can either manage these assets themselves or outsource the management. Asset managers rather act as agents to the asset owners (Blackrock, 2014). Due to proximity, all the Swedish members of the alliance are included in the case. Also since the inclusion of ESG factors into the investment process of institutional investors appears to be less controversial in Sweden than in other areas of the world. An example of this is the second directive of the Swedish public pension funds (AP-funds) which says "*...the funds carry the trust of the society, why attention should be given to the environment and ethics in the investment decisions without compromising with the overarching goal of achieving a high return.*[8]" (Riksdagen, 2007, section *AP-fondernas uppdrag*). Additionally, the Swedish government recently did a press release requiring the Swedish financial system to better enable sustainable development, and to do this less temporarily than before (Regeringskansliet, 2020). However, for us to introduce additional perspectives and challenge the liberal view on ESG inclusion and the data obtained from the Swedish asset owners, non-nordic members were further included in the case. In total, all the Swedish members (Folksam, AMF, Alecta and

---

[8] Free translation by the authors

Nordea Life & Pension) were included, as well as Aviva Investor (representing the asset management side of Aviva), the first and founding member Allianz and the overarching organization PRI. The case will, therefore, have an embedded structure with multiple units of analysis to allow for data from more instances to be compared and assessed (Yin, 2014; Dul & Hak, 2008).

3.3 Data collection

Interviews are one of the main sources of case study evidence (Eisenhardt, 1989). In this case, seven semi-structured interviews were conducted with relevant individuals working within the responsible investing departments or in some other way focusing on ESG factors in their role. Before the interviews, an introductory Interview guide in Swedish or English was sent out to the respondents, (See *Appendix 1* for the English version). From reading previous literature on the subject and incorporating the theoretical framework the open-ended interview questions were formed to allow the interviewee to talk freely about the area at hand. Since these interviews are the main data-source the questionnaire was meticulously developed, with revisions done by our supervisor to ensure a high-quality data collection. According to Eisenhardt (1989), the optimal number of instances in a case study is said to be 4-10, which justifies a total of seven interviews, lasting about 30-60 minutes. The interviews were conducted using various digital media (Zoom, Skype-for-Business, telephone, WebEx) and recorded with both of the researchers' mobile devices to avoid the full reliance on a single device. Only one interview, with Respondent 3, was conducted in Swedish. The direct citations included in section *4. Empirical findings* from this interview are thus translated into English by the authors. A total of seven interviews were conducted, ranging from 29:34 minutes to 1:00:29 hours, and further details on each interview are presented in Appendix 2 - *Summary of interviews.*

3.4 Data analysis

The most challenging and least codified part of a case study is the process of analyzing the data since this process varies greatly between different kinds and magnitudes of studies (Eisenhardt, 1989). Essentially, there is not a right way of conducting the qualitative data analysis, and many times it ends up in a learning-by-doing process (Froggatt, 2001). However, for us as researchers to make valuable interpretations beyond the raw data, there is a need for a process that assists in creating concepts, themes, categories and codes (Hunter, Lusardi, Zucker, Jacelon &

Chandler, 2002). A systematic stepwise-method which provides a point of departure regarding the analysis is the QUAGOL-method presented by Dierckx de Casterlé, Gastmans, Byron and Denier (2012). The initial steps in this method, while also being a part of the data analysis, provides an extensive preparation and helps us cognitively open our minds for new meanings and perspectives (Dierckx de Casterlé et al., 2012). Together, all steps will make us get to know the data more and more as all data is thoroughly and iteratively assessed. The analysis and data handling process is divided into two parts containing five steps each.

The preparing part aims to guide the researchers in grasping and getting an overview of the material. This was done by transcribing the interviews and reading the transcripts with an open mind, making short notes in the margin on subjects that stood out or caught one's attention (1). After this, a separate Interview Narrative Report for each interview was written, containing the essence of what the respondent answered concerning the research question, acting as a concise summary of each interview (2). Thereafter, we re-read the interview transcripts, created broad concepts and themes to capture the answers in the interview, and transferred these into separate Conceptual Overview Schemes for each interview. These concepts could have been expressed either explicitly or implicitly in the interview. In this stage, the wording of the concepts are still left fairly ambiguous and un-precise (3). Following this, the relevance and appropriateness of the concepts from each Conceptual Overview Scheme were verified and compared with its respective Interview Narrative Report through a fitting test (4). Through a workshop-inspired constant comparison process, within-case and across-case analyses were conducted. This process developed, refined and re-grouped the concepts from each Conceptual Overview Scheme into a common Overarching Conceptual Interview Scheme, resulting in 15 concepts in total at this stage (5). These initial steps are all done to obtain a detailed understanding of the data before utilizing qualitative data analysis software. When introducing the data analysis software in part two we used NVivo 12, which is provided by the School of Business, Economics and Law at the University of Gothenburg. In part two, the 15 concepts which step 5 resulted in were compiled into a non-hierarchical list of concepts and inserted into NVivo 12 as preliminary codes (6). The interviews were yet again re-read, and passages and sentences were coded with the corresponding concept using NVivo 12. A critical approach regarding whether the concepts can help answer the research question, or if any codes are missing, redundant or too abstract was adopted. This stage resulted in one additional concept and a total of 16 concepts or codes (7). In the following step, we read and reassessed the suitability of each

citation under each concept through a cross-case analysis and made adjustments when needed. This provided the opportunity to split up the concepts into sub-concepts or merge into more overarching such. Finally, we sought to articulate and find the common message and meaning of each concept. (8). In the two final steps, these concepts were integrated and interrelated, forming a conceptual framework to help answer the research question (9), and to finally be presented as the empirical results together with important quotes (10).

By using this method, the interviews are ensured to maintain their individual story and essence while also contributing to the overarching understanding and the final answering of the research question. When doing the analysis, these detailed steps served as a helping and guiding light to ensure that nothing important was missed or that anything was done too hasty. For an overview of the development of concepts using the QUAGOL-method, please see *Appendix 3 - Development of concepts during the analysis process.* In section *4. Empirical findings* we will in detail explain and describe the four main concepts, and respective sub-concepts. These concepts are developed and compiled through the analysis of the seven interviews, and are *Fiduciary responsibility, Implicit and explicit ESG, United investor action* and *Transitioning for real-world impact.*

3.5. Critical assessment of the method

This research is conducted through the case of institutional investors' commitment to AOA in combination with their fiduciary duty. According to Eisenhardt (1989), the optimal number of instances in a case study is said to be 4-10, which is met by the inclusion of seven different case companies. Despite this, we acknowledge that more instances and interviews would, as always, have been even better and contributed to an even more profound data collection. Nevertheless, there are several reasons why the number of interviews was seen as sufficient. Firstly, the answers from the different respondents were all reinforcing each other and approaching an empirical saturation and secondly, many requested respondents declined by referring to a single respondent of that specific organization, who was already included. This also provides the opportunity for a more profound analysis of each instance. Additionally, a note taken from one of the respondents was that through the nature of our questions, focusing on shareholder engagement and equity markets, we had excluded the private market and real assets (Respondent 6, 2020). On the contrary, the asset owner perspective with the AOA-focus, was recognized by another respondent as an interesting and new take on an issue usually discussed

from a fund manager's point of view (Respondent 4, 2020), and we therefore judge this to be a minor issue. Moreover, since the focus of AOA is to achieve net-zero GHG, the climate aspect is the only area of ESG incorporated into this research. We acknowledge this limitation but argue that with the time and resources at hand all aspects cannot be sufficiently taken into account, why AOA provides a good case for this aspect. Furthermore, the novel formation of the AOA allows for an undiscovered empirical setting combined with an academic area of interest.

3.5.1 Critical assessment of data analysis method

As previously argued, no single way of conducting qualitative data analysis will be perfect for every case study design possible. To overcome the challenges of data analysis we have reflected upon the *six major problems* that researchers often experience and struggle with, as presented by Dierckx de Casterlé et al. (2012). By following the QUAGOL-method we are confident it will help us overcome these common problems. We especially believe following the method will mitigate the risk of oversimplification and that moving back and forth between within-case and across-case analyses will help us exploit the full potential of the data and use of the contextual richness. However, there are potential limitations to the method as well. While the iterative process of going through data is important, it could also make it more difficult to be selective of information which in turn could cause excessive use of words. However, we do believe the preliminary steps of the QUAGOL-method have helped us better stick to the essence of the interviews. But although one could successfully grasp the essence of the interviews, this does not automatically contribute with valuable insights into the research phenomenon at hand, hence, a potential pitfall. Besides this, the method consumes a lot of time which might require the researchers to make trade-offs between different activities during the course of the project to meet deadlines. The across-case and within-case analyses arguably hold one of the strongest activities of the method. This part of the analysis adds further responsibility to the researcher and requires experience and analytical skills to focus on that particular case and avoid becoming biased by bringing thoughts, ideas and insights from one case into the analysis of another (Dierckx de Casterlé et al., 2012). Furthermore, QUAGOL does not help when choosing and formulating the concepts, instead the researchers must be creative and do the abstract thinking themselves when coming up with them. This is both challenging and runs the risk of laying a framework of suboptimal concepts if not done properly. The aforementioned initial steps of the QUAGOL-method arguably help you to overcome this limitation.

The QUAGOL-method has its limitations and potential pitfalls, but no method can automatically guarantee quality. Therefore, we have used this method as a guiding tool, as suggested by Dierckx de Casterlé et al. (2012), and not as a rigid and strict procedure. After profound research of an eligible and relevant qualitative analysis method and critically assessing different methods, we concluded that this approach will be the most efficient one in helping us handle our case data and answer our research question.

4. Empirical findings

Through the steps following the QUAGOL-method discussed in section *3.4 Data analysis*, the interviews conducted were thoroughly analyzed and compiled into what we call four main concepts with 2-4 sub-concepts respectively. A brief overview of these concepts is found in Appendix 3, but in this section we describe and explain the concepts in detail. These main concepts are *Fiduciary responsibility, Implicit and explicit ESG, United investor action* and *Transitioning for real-world impact*. In section *5. Analysis and discussion*, these concepts will be further discussed and put in relation to the theories presented in section *2.2 Theoretical framework.*

4.1 Fiduciary responsibility

When asking questions on the respondents' interpretation of the fiduciary duty, all respondents highlighted the obligation to generate returns for the clients in a responsible way as the main focus. There was a strong consensus that to do this, a long-term perspective is needed when investing the clients' money to get a good risk-adjusted return and to ensure the money will be there in the future (will be further elaborated in section *4.1.2 Long-termism*). A part of doing that is contributing to maintaining a stable financial system, but also balancing the needs of all stakeholders and including ESG considerations such as climate risks into the investment decisions. Respondent 6 refers to the Financial Reporting Council's 2020-stewardship code when he talks about the "*modern interpretation of the fiduciary duty*". The introduction to this code says "*Environmental, particularly climate change, and social factors, in addition to governance, have become material issues for investors to consider when making investment decision and undertaking stewardship*." (Financial Reporting Council, 2020, p.4). Respondent 5 further explains that "*...acting in a responsible way [...] should in most cases also enhance returns in the long-run and reduce risk [...] hundred percent covering what a client would expect*.". The membership of the AOA is therefore said to help fulfill the fiduciary duty, and the motives for this commitment are therefore financially based. Responsible investments are said to include environmental, social, moral and ethical aspects, as the profit of today cannot be obtained at the cost of future generations or trough harmful investment behavior. However, the financial aspect is the primary responsibility. Consequently, if there is no investment rationale in a certain decision, be it green or not, it is not considered - "*...we can't and won't save the world on behalf of our clients.*" (Respondent 7).

4.1.1 Shifting mindsets

The finance sector, including large asset managers, are getting more involved with climate-related issues and more aware of their previous harmful behaviors and their role in tackling these issues. This is a reason why the respondents with a general voice explain that inclusion and acknowledgment of climate and its impact have lately increased, leading to updated definitions of the fiduciary duty and investment products. Moreover, this change is fast-paced, meaning that these definitions, traditional connections between finance and sustainability, and the financial products offered by institutional investors, will soon be different again. Respondent 7 confidently stated this when saying "*...pretty sure that, you know, whatever we did today will be sort of laughed at, and [in] 20 years [we will] be like, God these guys were basic and simple.*".

4.1.2 Long-termism

The respondents specifically highlight long-term thinking and maximizing returns as being of utter importance for institutional investing, and that companies with a sound ESG-strategy will perform better over time. The key idea of the respondents is that you should not invest if you do not believe those investments will generate positive returns in the long-term. This investment approach was explicated by Respondent 6 when saying "*...we are really just talking about short-term versus long-term. And an institutional investor should always be thinking as long-term capital because that's what institutional investment is. You know? [If] you are thinking about generating returns in year one only and not thinking about where those returns might be in year two, year four, year five, year ten - then you are not doing investment right in the first place.*". It is further added that their responsibility as institutional investors is to make sure that the beneficiaries' money will be there in the future. ESG consideration becomes an important parameter here since non-ESG compliant investments today could cause future offsetting costs which in turn will affect the investments in real ways. What complicates this is that regulatory tendencies and possible changes must be considered and prepared for. Once again, the respondents exemplify carbon-intensive assets to fit into this statement but further mentions weapons and other unethical investments, although their return could be positive.

4.1.3 Upside- and downside risk

Integrating ESG considerations into the investment decisions adds another risk-lense to the risk management practices (Respondent 7). Some of the future risks of climate change are real physical risks like for example flooding and the destruction that follows, as well as financial risks stemming from possible major write-offs in fossil-fuel companies. It is said that mitigating these climate risks is about mitigating long-run business risk, which ultimately is a way of responsibly protecting the beneficiaries. Consequently, this is not about gaining reputational benefits, although overlooking these factors can introduce a reputational risk. This since the market sentiment, societal expectations and trends have an impact and should be followed to stay relevant (Respondent 7). The commercial success often depends on where you stand in certain questions, like for example owning an oil company. This makes it difficult to communicate in a clear way to clients regarding decisions on engagement or divestment in certain sectors since these issues are complex and not black-or-white (Respondent 4). The highlighted key-points in this net-zero mission is the protection and prevention of damage to the portfolios, as well as the anticipation of changes in supply and demand in addition to the regulatory dynamics in certain sectors. Moreover, as several respondents mentioned, this rapid change can introduce opportunities if you position yourself on the right side of it. "*[A] risk well-managed usually is an opportunity*". as Respondent 7 puts it. Using tools like the TCFD-framework[9], and methods developed through the AOA, the portfolios are put through stress-testing to assess the climate risk impact.

4.1.4 Transparency towards stakeholders

Crucial aspects to maintain credibility when engaging in different initiatives are transparency and communication towards stakeholders. More specifically, it is about informing them of your taken as well as intended actions and strategies. This is done through for example incremental reporting on targets and progress. However, since the institutional investors included in this case bear responsibilities towards millions of beneficiaries, it is mentioned to be difficult to inform, listen to and consider all the individual views and perspectives. Therefore, there is no direct communication with stakeholders and beneficiaries regarding individual investment decisions, but they rather conduct more general stakeholder dialogues and surveys to keep track of the aggregated interests, views and questions of the beneficiaries in the ESG area. However,

[9] https://www.fsb-tcfd.org/

reporting and maintaining transparency on different ESG criteria, initiatives and goals, either before or after engaging in them "*...of course makes the governance and operational work easier.*" (Respondent 3).

4.2 Implicit and explicit ESG

4.2.1 ESG - a natural extension

The respondents made it clear that ESG considerations were already a part of their operations implicitly through their vision, values and overall strategy before joining the AOA, but also explicitly through their practices of integrating ESG into the investment process (further described under section *4.2.2 ESG integration into the investment process*). Respondent 3 emphasized their implicit approach to ESG when explaining that "*It is our mission as we see it. [Our] vision is also that our beneficiaries should feel secure in a sustainable world, and that is something that pervades everything we do in our work.*". Furthermore, the work of decarbonizing the portfolio towards net-zero requires investments, people, time and transparency. Sticking to this goal is a way of holding yourself accountable for a long period, or in the words of Respondent 7, to "*...put your neck on the chopping board...*". There is also a need for being transparent of all the intermediate steps necessary to take during the years in between, which further boosts the accountability. Moreover, many participants have already committed to several initiatives before the AOA, but AOA acts as a consolidation of all these commitments rather than being an add-on.

4.2.2 ESG integration into the investment process

In a practical sense, ESG integration is about extending the notion of stakeholder capitalism, and including the planet as a stakeholder. There are many different ways of integrating ESG into the investment decision process, hence, there is no strict formula for it. However, the different methods all share the same purpose of ensuring a minimum level of sustainability in every investment decision made. The most common methods include using third-party knowledge to filter and follow up on companies' ESG performance; positive screening such as following best-in-class indices that target the top ESG-performing companies; and negative screening processes that exclude the worst. The exclusion of companies is challenging since some of them have the potential of transforming into good ones and need support in doing that (further presented in section *4.4 Transitioning for real-world impact*). However, all respondents

agree that there are a few sectors such as weapons, that should be excluded regardless of the short-term benefits they could entail, and instead highlight the long-term benefits of integrating ESG into the investment decisions. Ultimately it comes down to identifying, checking and screening against externalities that do not show up in conventional financial ratings, and that in one way or another will affect institutional investors because of their global presence.

4.3 United investor action

4.3.1 Developing common ground

Among all the respondents one major reason for joining the AOA was to develop a common understanding and language regarding the commitment of becoming net-zero in 2050. As one of the respondents put it: "*...for me, AOA is more of a how than a what*." (Respondent 1). A commonly mentioned issue is that methodologies and data for measuring risk, progress and targets seem to be lacking but by coming together in the AOA, a common understanding can be formed through the inclusion of different aspects, experiences and ideas. Respondent 7 further highlights this to be the main reason for joining the alliance and stresses the inconsistency that would occur if investors developed measurement methods and standards individually. Moreover, one of the two principles of the AOA is that these targets ought to be based on the best available science (principle two is discussed in section *4.4 Transitioning for real-world impact*). By including third party knowledge through initiatives like Science-based targets[10], this facilitates a common understanding of methods, data and a relevant target setting. Setting targets based on science is also mentioned to be important to increase the credibility towards stakeholders. According to the respondents this sort of continuous development will help the progress-reporting and further enable the collaboration in the alliance.

4.3.2 Borderless collaboration

Collaboration is highlighted by all respondents as highly beneficial when working towards the goal of net-zero, mainly through the increased efficiency when developing a common understanding, as covered under section *4.3.1 Developing common ground*. By this, Respondent 4 means that there is a logic behind putting the competition aside, integrating many different actors, and instead collaborating beyond the conventional partnerships. It is important

[10] https://sciencebasedtargets.org/

to acknowledge that institutional investors are mainly finance experts, and thereby should include scientific experts, strategic partners like the WWF and the UN, to widen their perspectives. By connecting the dots of heterogeneous participants, they create a corporate ecosystem where everyone in the whole sector value-chain is involved, including the high-emitters. Respondent 5 mentions the cross-sector round-table discussions as an important and efficient way to facilitate this transition and get everyone on board, which will be elaborated under section *4.4.2 Multi-level engagement*.

4.3.3 Capital as power

By bringing together investors from different regions and sizes, the assets under management of AOA becomes even greater. Combined with the support of PRI and the UN, this gives them greater convincing power and impact when pushing the transformation of a whole sector supply chain. This is highlighted by Respondent 5 when saying "*So if we, as Asset Owner Alliance with all this capital in the background [tell] the companies and the sectors, policy - whoever is the stakeholder - that we want them [to] tackle climate change, this is a very strong sign.*". Moreover, asset owners have a broad investment universe and govern the asset managers to whom some have outsourced the capital management, and therefore have a vast impact on their decisions.

4.4 Transitioning for real-world impact

To achieve the goal of reaching net-zero by 2050, all the respondents stressed the importance of transitioning the economy and reducing emissions for a real-world impact. This is only possible to achieve through a reallocation of capital and decarbonization of the existing portfolio. As Respondent 3 said "*It is not about just selling our holdings tomorrow to get a nice portfolio, or selling in 2049.*". Instead, through reallocation of capital, investors seek to invest, engage and support their portfolio companies in this transition. Respondent 4 repeatedly highlights the necessity of noticing a sufficient commitment amongst the portfolio companies towards the transition to remain invested and continue supporting them with capital. Respondent 4 further mentions that there are not many companies today that are committed enough to change themselves, which makes it difficult for institutional investors to defend supporting them with resources. Therefore, an intensification of consequence strategies is important in these cases to increase incentives to change. Targeted companies can both be low-

emitters, or high-emitters who show potential to change and create a real-world impact. Additionally, some of these high-emitting sectors have a business-model incompatible with the net-zero goal, but also valuable competence and infrastructure necessary to achieve this transformation. Therefore, they should be included in the transformation to leverage the real-world impact. The capital needed to meet the environmental demands and mitigate future damage must come from the investments made today. Moreover, there is a need for more disclosure and reliable data from companies since this will increase pressure to continue reducing emissions. Respondent 7 concludes what getting real-world impact is about: "*...you give somebody more money because you believe in them or you give them less or no money, you know, and ultimately you divest. We think that this leads to an undesired effect, given that we want the real economy to decarbonize.*".

4.4.1 ESG-related challenges and obstacles

The main strategies of decarbonizing the existing portfolio and reallocating the proceeds to good investments are also presented as being the main challenges for the members of the AOA. This since the technologies which generate stable returns through stable demand, often tend to be old and high-emitting such (Respondent 6). The methodological challenges and different views among the members on how to do this are also present. Moreover, although the commitment is long-term, the more frequent incremental reporting is every 5 years following article 4.9 in the Paris agreement[11], making target-setting more difficult. To not contradict the fiduciary duty, the target-setting and investment decisions must also maintain a holistic portfolio perspective and be motivated to generate returns for the beneficiaries, and not only be focused on the well-being of the planet.

4.4.2 Multi-level engagement

There is an opinion that engagement with the portfolio companies is more favorable than divestment. Institutional investors must acknowledge their role and capacity, utilize the leverage obtained by their size, and through active ownership push change to get the desired results and affect the portfolio companies into becoming more ESG-compliant. However, the

[11]"Each Party shall communicate a nationally determined contribution every five years in accordance with decision 1/CP.21 and any relevant decisions of the Conference of the Parties serving as the meeting of the Parties to this Agreement and be informed by the outcomes of the global stocktake referred to in Article 14." (UNFCC, 2015)

engagement should stretch further than to include only the portfolio company but should also target the whole supply chain. Cross-sector round-table sittings were named as a very efficient method to create inclusiveness, embrace the feeling of common responsibility amongst all parties, and find common solutions since no company or sector operates in isolation. Furthermore, it was stressed that institutional investors should use all the engagement tools in their toolbox such as the common methods of dialogue, voting, appointing board members and attending annual meetings. Another way is to include external knowledge to prove effects and to be represented by third-parties which connects many investors in confrontational dialogues. Finally, policy-engagement is a highly important aspect, explained by Respondent 7: "*...a lot of the AOA-related engagement is towards policymakers [...] to enable our commitment [...] disclosure standards, data-standardization and all that stuff.*". Moreover, this engagement is often needed to lower the risk for individual companies to invest in specific technologies. Additionally, this strives to facilitate the work for policymakers by providing confidence and enable them to focus on their policy-development. Finally, the institutional investors show commitment through targeted investments to help transform emitting industries.

4.4.3 Divestment decisions

There are many different reasons why institutional investors sometimes decide to divest one of their portfolio companies, however it is perceived by the respondents as being a last-resort action. It also seems to be a consensus that, in terms of negative consequences and putting pressure on the portfolio companies, the divestment decision is a much stricter strategy than the contrasted one, engagement. Moreover, when divesting, all impact and responsibilities you had when owning that company are left neglected. Therefore, this method will not help non-ESG compliant companies to transform, and consequently, not lead to a real-world impact and well-needed change. Therefore, due to the lack of better consequence strategies, and despite the sub-optimality of it, the divestment option must always be present as a reminder and warning for the portfolio company.

5. Analysis and discussion

In this section, we will analyze and discuss the empirical findings with the research question in mind and in connection to the theories presented in section *2.2 Theoretical framework*. At the end of this section, we present a summarizing table containing the main concepts and respective sub-concepts along with the associated theoretical points summarized in Table 1 in *2.2 Theoretical framework*. The final conclusions will be presented in section *6. Conclusion*.

5.1 Fiduciary responsibility

The respondents repeatedly brought up the need of having a long-term view in the investment decision process, as well as reducing, or at least anticipating, the different risks and opportunities that accompany climate change. Consequently, this becomes an important rationale behind considering ESG in the investment decision process, and a way to combine ESG considerations with their fiduciary duty. Both of these motives, long-termism and upside- and downside risk, are reflected by two of the four reasons Bénabou and Tirole (2010) present on why institutional investors engage in CSR. These reasons are the increase in negative externalities from globalization and the long-term costs of climate change. Additionally, Respondent 5 explained that the inclusion of ESG factors is something that clients ought to expect from their trustees, due to the abovementioned factors. This further implies that a third reason, CSR becoming a normal good, is present in these discussions (Bénabou & Tirole, 2010). An explanation to this is that beneficiaries, and people in general, become more aware of the impact climate change can have on their pensions and savings. Therefore, there is an expectation for this to be integrated into the investment strategies, thus connecting ESG considerations to the fiduciary duty. This can also be related to the CSR-view delegated philanthropy in which the presence of transaction and information costs better enables corporations and institutional investors to engage in socially responsible activities on behalf of the stakeholders or clients rather than them doing this individually (Bénabou & Tirole, 2010). If this is true, then there is an underlying economic rationale behind institutional investors being the ones engaging in ESG initiatives instead of the beneficiaries. However, it does not necessarily say that this is what the beneficiaries want, although the aforementioned expectations imply that it is. Contrary to the third point made by the Freshfield report, saying that trustees need the consent of their beneficiaries to decide on what ESG issues to focus to permit ESG inclusion (Freshfields Brunkhouse Deringer, 2005), none of the case companies

aimed to gather one coherent voice among the beneficiaries. Rather, they collect views and questions on an aggregated level through annual customer surveys and through maintaining transparency in general. Taking the view of the Freshfield Report, this would suggest that the combination of ESG considerations and the fiduciary duty is not possible. Consequently, there is a need for further explanation on how to harmonize this.

On another note, the perspective of coercive isomorphism suggests that formal and informal pressures force organizations to become or behave more like one another (DiMaggio & Powell, 1983). The responses in the interviews indicate that climate change is an informal force that pushes the institutional investors to include these factors into risk stress-testing etc.. Moreover, the shifting mindsets and legitimacy concerns regarding these issues are increasingly putting pressure on actors to consider ESG. Since these forces are pushing institutional investors into a certain structure and behavior, it becomes even more crucial that what they become is congruent with what the beneficiaries want. This in combination with the difficult task of fulfilling the third argument in the Freshfield report, could be a point of concern. Finally, in the initial literature review of this thesis, and also mentioned by Bénabou and Tirole (2010), there is a consistent message that taking a stakeholder value approach - thereby balancing the needs of all stakeholders like employees, society and environment - stands in contrast to a shareholder value approach which is mainly focused on maximizing profit. The conceptual tongue-twister throughout this case has been that the actors wanting change and positive outcomes on a broader scale are also the ones requiring a decent financial return, namely the institutional investors. This is shown through the conviction among the respondents that companies with sound ESG-strategies will perform better over time, and ESG integration will thus contribute to a long-term positive return. This is further discussed by Bénabou and Tirole (2010) through the view on CSR that suggests a win-win situation where companies who include ESG factors are doing well by doing good. The above-mentioned factors imply that discussions about the allegedly contrasting views on stakeholder and shareholder priorities, at least when it comes to large institutional investors, are obsolete.

5.2 Implicit and explicit ESG

According to DiMaggio and Powell (1983), the institutionalization of rules and legal requirements might eventually be reflected in the organizational structures and through rituals that the organizations can gather around. From the empirical results, this coercive isomorphism is reflected in the practice of integrating ESG into the investment process, utilizing ESG best-in-class index or negative screens, and thereby ensuring a minimum level of sustainability. However, this does not imply a guaranteed improvement in financial returns. Moreover, one of the views on CSR presented by Bénabou and Tirole (2010), was insider-initiated corporate philanthropy saying that the mission to engage in ESG issues is derived from the organization itself and the morals and preferences of top management or board members. As many of the respondents pointed out, the decision of committing to the alliance was simply a natural and logical extension of their current strategies and goals. The respondents also talked of their routines and investments practices that already were in place when including ESG factors. This reinforces the point that ESG considerations in the investment process are derived from within the organizations and an inherent part of what they already believe in and have done before joining the AOA. If that was the sole rationale of engaging in CSR, the prediction of Friedman, that corporations devoting their investments to charity with others' money (see Bénabou & Tirole, 2010) would become a reality and thus contradict the fiduciary duty of investing in the best interests of the beneficiaries.

Accordingly, it is difficult to derive one consistent answer regarding the Implicit and explicit ESG, concerning the research question. On the one hand, having ESG considerations inherent in the organization and seeing the AOA as a natural extension, might lead to investment decisions taken only due to a certain moral agenda, subsequently contradicting the fiduciary duty. But on the other hand, such internalized motives could automatize and remove possible friction in internal process when including ESG, reducing resources needed for such considerations. However, as discussed in other parts of section *5. Analysis and discussion*, the implicit ESG motivations are not the only way how institutional investors work with combining their fiduciary duty with ESG considerations. The quote from Respondent 7 emphasizes this: "*...we can't and won't save the world on behalf of our clients.*".

5.3 United investor action

One motivation articulated by Bénabou and Tirole (2010) on why institutional investors engage in CSR referred to the disbelief in the ability and capacity of governments to handle the issues from climate change sufficiently and efficiently. Obstacles for governments included territorial, political and jurisdictional reasons which make it harder and costlier for them to reach areas outside their main responsibility without jeopardizing their political reputation. Interestingly, none of the respondents expressed any skepticism towards governments as such, nor did they mention the government as the main responsible actor in tackling climate change. On the contrary, the emphasis was put on the power of approaching these issues together and enabling each other's work. With the convincing size of the institutional investors' capital and their broad investment universe, they could also provide confidence through their presence and help the policymakers on this issue. So, rather than being motivated by their lack of trust in governments' efforts in this area, institutional investors perceive ESG related issues to be a part of their main responsibilities as institutional investors. This could be what Bénabou and Tirole (2010) meant when stating that institutional investors are in a better position to help this transformation than governments alone.

The respondents were not only confident of their responsibility in working with climate change, but also communicated a certain logic of putting aside competition and joining forces through borderless collaboration beyond the conventional partnerships. In this setting, AOA serves as a platform that enables the members to come up with unified solutions; share ideas, knowledge and experience; set common targets and measurements; and by this develop a common language. This was something stated by the respondents as something which the whole institutional investor sector needs, especially when striving towards becoming Paris-aligned. Hence, these are the main reasons why the respondents' institutions joined AOA in the first place. These reasons resemble what DiMaggio and Powell (1983) name as political influence and informal pressures that force organizations into joining in collusion. Moreover, the developed common language serves as a methodology that the members of the alliance bring into their organizations and practices, making them more alike one another. Although implicit and informal, this indicates that a form of coercive isomorphic pressure is present. That is why this could be an indirect explanation of how they jointly work with ESG concerns with the ultimate aim of serving their beneficiaries.

Moreover, by developing this language and setting standards, other organizations and institutional investors could model after AOA regarding these ambiguous issues. Therefore, the motive of joining and forming the alliance can be seen as an aspiration to become the modeled organization that, in a setting of mimetic isomorphism, serves as a guiding light in an uncertain environment. As discussed above, borderless collaboration is of crucial importance when wanting to be successful in developing the right methodology and handling ESG issues. Alongside the AOA, all members searched for support from third-party knowledge and joined additional initiatives to help to reach the set targets. Hence, normative isomorphism could arguably be another influence that, through the development of professional networks, makes the members of AOA and their collaborating partners become more alike. Joining initiatives and collaborations like AOA is thus a concrete way of managing the challenge of combining the fiduciary duty with ESG consideration since the united engagement in developing a common language and methods contribute to the success of meeting this challenge. Additionally, due to the sense of uncertainty which the net-zero goal presents, a joint initiative like the AOA offers a practical way of meeting this uncertainty by acting and serving as the modeled organization. Subsequently, this helps member organizations serve their beneficiaries in the best way.

5.4 Transitioning for real-world impact

As mentioned in *5.1 Fiduciary responsibility*, the long-term costs from climate change, the increase in negative externalities from globalization, as well as the awareness of this change are reasons for engaging in CSR (Bénabou & Tirole, 2010), and ultimately why this must be a part of the fiduciary duty. To mitigate these costs and negative externalities, one main principle of the AOA, besides having science-based targets, is to achieve their net-zero goal through having a real-world impact on the companies and the economy, and not through selling off the high-emitters to get a clean portfolio. Decarbonization of the existing portfolio and reallocation of resources into low-emitting sectors are two strategies mentioned by the respondents on how to reach this goal, mainly through engagement and support to companies who show sufficient commitment to the transformation. However, there are two sides to this coin, and these central strategies on how to reach net-zero are also two of the main challenges on this mission. In such circumstances, with challenges and ambiguities, mimetic isomorphism suggests that powerful and experienced organizations are modeled through the force of uncertainty (DiMaggio & Powell, 1983). In the AOA, practices and activities on how to do this are developed and assessed

together, further setting the standard on how to work with engagement and divestment. For example, throughout the interviews, all respondents talked about divestment as being the last resort since this would remove any chance of affecting the company approach to lowering the emissions and achieve a real-world impact. If the investors' approach to divestment has always been like that or if it has developed through the common sentiment in the alliance remains unsaid, nevertheless, AOA acts strongly as the modeled organization on these issues. To sum up this perspective, institutional investors are trying to mitigate the long-term costs and negative externalities by reallocating resources and decarbonizing the existing portfolio. Therefore, this inclusion of ESG considerations is perceived to be in the best interest of their beneficiaries, hence a direct and practical way of combining their fiduciary duty with ESG considerations.

Table 2 - Summary of conceptual findings and theory application

Conceptual findings	Theory 1 Institutional isomorphism	Theory 2 Reasons and views on CSR
Fiduciary responsibility - Shifting mindsets - Long-termism - Upside- and downside risk - Transparency towards stakeholders	- Coercive isomorphism	- Normal good - Increase in negative externalities - Long-term costs - Doing well by doing good - Delegated philanthropy
Implicit and explicit ESG - ESG - Natural extension - ESG integration into the investment process	- Coercive isomorphism	- Insider-initiated corporate philanthropy
United investor action - Developing common ground - Borderless collaboration - Capital as power	- Coercive isomorphism - Mimetic isomorphism - Normative isomorphism	No evident connection
Transitioning for real-world impact - ESG-related challenges and obstacles - Multilevel engagement - Divestment decisions	- Mimetic isomorphism	- Increase in negative externalities - Long-term costs

The rows in this table are divided into the four main concepts and respective sub-concepts, while columns two and three represent the two theories constituting the theoretical framework, previously summarized in Table 1. *In the matrix, the empirical conceptual findings are put in relation to each theoretical concept. The motivations and discussion of these relations are presented in the text above.*

6. Conclusion

Despite that many of the global investor initiatives like the AOA are founded for the greater good of the society and environment, there are persistent doubts on whether these sorts of commitments, and thereof ESG considerations, can be combined with the fiduciary duty towards their beneficiaries. The traditional reading of the fiduciary duty assigns the passage *best interest of the beneficiaries* with the meaning of maximizing the financial returns, and this has been argued to be in contrast to including ESG considerations into the investment process. In this thesis, we have sought to examine and clarify how members of the AOA are working with uniting these two aspects. Through a descriptive interview case study, and by using the QUAGOL-method to systematically work with and analyze the empirical material, we found four main concepts to answer the research question - *Fiduciary responsibility, United investor action, Implicit and explicit ESG* and *Transitioning for real-world impact.* At the end of this concluding section, we present our four main findings through a short list, followed by a suggestion for future research.

Regarding *Transitioning for real-world impact,* we find that the members mainly strive towards becoming net-zero through the reallocation of resources and decarbonization of the existing portfolio. Through this, they intend to mitigate the long-term costs and negative impact of externalities. Subsequently, these are direct ways of including an ESG consideration into the investment process and thereby meeting the fiduciary duty of serving the best interest of the beneficiaries. Moreover, relating to *United investor action,* the borderless collaboration and the development of a common language enables the managing of the uncertainty and ambiguity around some ESG questions. This could, therefore, be an indirect way of how institutional investors jointly work with ESG concerns with the ultimate aim of serving their beneficiaries. Since AOA works as a platform that facilitates this, it offers a practical way of meeting ambiguities by acting and serving as the modeled organization. This helps to manage the challenge of combining the fiduciary duty with ESG considerations since the united engagement to develop a common language and methodology contributes to overcoming this challenge. However, the role of *Implicit and explicit ESG* in this question presents difficulties in deriving one coherent message. On the one hand, the fact that institutional investors consider ESG as a natural extension might lead to the trustees taking investment decisions solely based on moral motives, contradicting the fiduciary duty. On the other hand, that very same fact could

enable the inclusion of ESG considerations into the investment process, without causing internal frictions or having any adverse effects on the financial outcomes.

The main motivation behind combining the fiduciary duty and ESG considerations was however found in the concept of *Fiduciary responsibility*. Including ESG factors into the investment process enables a long-term view and an additional perspective of climate risk affecting the financial outcomes. Moreover, it is more cost-efficient for institutional investors to engage in ESG initiatives than for individual beneficiaries to do this. Therefore, beneficiaries with an increased awareness of the impact of climate change expect their trustees to do this. Subsequently, this suggests that by including ESG considerations into the investment decision, the best interest of the beneficiaries is met, and thereby an indirect way of combining the fiduciary duty with ESG considerations. However as discovered, efficiency motives drive the institutional investors to act first and ask later, since it is frankly impossible to gather the opinion of every individual beneficiary. This, therefore, contradicts the third argument in the report by Freshfield Brunkhouse Deringer (2005), requiring consent among all the beneficiaries. However, there has been a call for a re-evaluation of the fiduciary duty in previous literature (Sandberg, 2013; Richardson, 2013). Therefore, to tie the findings and insights of this thesis together and pinpoint the final conclusion, we humbly suggest a reconceptualization of the *Fiduciary duty* into the slightly different *Fiduciary responsibility*. Although these are sometimes used interchangeably, we see a minor, but highly significant difference between the words duty and responsibility. This is underlined by the respondents' answers and discussed in this thesis, namely that institutional investors have a *responsibility* to include ESG considerations into the investment decisions in order to serve the best interest of their beneficiaries. Embedded in this responsibility lies the need of considering the long-term adverse effects that come from neglecting this, and the opportunities presented when including ESG.

Main findings: Four ways to combine the fiduciary duty and ESG considerations

1. *Transitioning for real-world impact* through decarbonization and reallocation serve as a risk-managing tool with the ultimate aim of achieving a good long-term return
2. Through *United investor action*, uncertainties on ESG methods and targets can be met through developing a common language, thereby mitigating ambiguities on ESG concerns
3. *Implicit and explicit ESG* considerations enable a frictionless inclusion of ESG factors into the investment process, provided that this is not only based on an internal moral agenda
4. It is the *Fiduciary responsibility* of investors to include ESG factors since this enables a long-term view and additional climate risk perspective on the financial outcome, and thereby expected by the beneficiaries to be included

To conclude, we present a suggestion for further research in this area. An interesting question that we see could benefit from being investigated is to assess the appropriateness of the stakeholder versus shareholder value approach, as discussed in section *5.1 Fiduciary responsibility*. For example, a literature review covering studies from both pro- and anti-ESG scholars could develop a more up-to-date pair of contrasting views and thereby move the very needed discussions regarding institutional investors' ESG considerations forward.

Appendix

Appendix 1 - English Interview Guide

Hello once again, and so nice that you are taking the time to be interviewed by us. In this interview guide, we will disclose important information and other things you might consider interesting. This in order to be as transparent as possible and ensure your comfort in participating in this interview.

Who are we?

We are Jenny (26yr) and William (30yr), and we are enrolled in the MSc in Accounting and Financial Management at the School of Business, Economics, and Law at the University of Gothenburg. This interview will be a part of our data collection for our concluding Master thesis.

Confidentiality and general information

- At your request, we can anonymize the name of you and/or your organization.
- We will conduct the interviews through Skype or other agreed upon method and wish to record the interview.
- The interview is expected to last 30-45 minutes
- The interview will be conducted in English.
- If needed, we might ask to complement the interview with an additional phone call and/or e-mail.
- You can access any material per request. This includes raw data such as recording and transcript, but also results and conclusions.

If you have any questions, thoughts or other requests regarding the interview, please don’t hesitate to contact us.

Interview questions and research area

The purpose of the study is to learn more about the following research question:

- *How do asset owners work with combining their fiduciary duty with ESG-commitment?*

We are especially interested in your membership in the Net-Zero Asset Owner Alliance (NAOA) and will thus focus a few of our questions around that. Our questions are carefully formulated based on current research within this area. Our ambition is to ask the questions specified below but will let the interview flow naturally. We have no pre-specified expectations on your answers and wish to take part of your own interpretations and opinions.

SHAREHOLDER ENGAGEMENT IN GENERAL

1. What shareholder engagement strategies do you mostly use?
2. What do you think of … as an engagement strategy?
    a. … dialogue
    b. … shareholder resolutions
    c. … voting
    d. … public confrontation
    e. … name-and-shame campaigns or blacklisting
    f. … divestment
        i. Positive screening?
        ii. Negative screening?
3. Can you tell us about an occasion when you chose to divest?
4. What do you perceive to be the main focus of your fiduciary duty?

PROCESS PRECEDING BECOMING MEMBERS OF NAOA

5. How do you motivate your NAOA-engagement based on your fiduciary duty?
    a. In what ways, if any, could an ESG-commitment help you fulfill your fiduciary duty better?
    b. What obstacles have you encountered when engaging in NAOA, considering your fiduciary duty?
6. What conflicts could emerge between your fiduciary duty and an ESG-commitment/Sustainability?
7. Why did you choose to become a member of NAOA?

DURING NAOA

8. How were the internal/external discussions/activities within your organization, beneficiaries, other NAOA-members etc.?

IF THERE IS TIME

9. Why do you think it is important to work together with other institutional investors regarding SRI?
    a. Do you believe that free-riding hinders SRI? Why? How?
    b. How could engagements like NAOA mitigate these problems?
10. How do you go about measuring…
    a. ...the emission changes from your portfolio companies?
    b. ...the success regarding your activities?

Thank you once again for doing this interview. We look forward to talking to you soon. Don't hesitate to contact us if you have any questions whatsoever.

Jenny Asplund, +46722229044, gusaspluje@student.gu.se or asplundjenny@hotmail.com
William Sam, +46707940848, gussamwi@student.gu.se or contact.williamsam@gmail.com

Appendix 2 - Summary of interviews

RESPONDENT	COMPANY	DATE OF INTERVIEW	LENGTH OF INTERVIEW
Respondent 1	AMF	2020-03-23	39:27
Respondent 2	Alecta	2020-03-25	29:34
Respondent 3	Folksam	2020-03-26	34:05
Respondent 4	Nordea Life & Pension	2020-03-26	1:00:29
Respondent 5	PRI	2020-04-02	34:26
Respondent 6	Aviva Investors	2020-04-08	42:47
Respondent 7	Allianz	2020-04-16	43:01

This table summarizes the seven data-collection interviews for this thesis. All interviews were conducted digitally through different media such as Zoom, Skype for Business, and WebEx.

Appendix 3 - Development of concepts during the analysis process

STEP 5-6	STEP 7	STEP 8	STEP 9-10
ESG-integration into the investment process	ESG-integration into the investment process	ESG-integration into the investment process	1. FIDUCIARY RESPONSIBILITY
Developing a common ground	Developing a common ground	Developing a common ground	Shifting mindsets
Borderless collaboration	Borderless collaboration	Borderless collaboration	Long-termism
Transitioning for real-world impact	Transitioning for real-world impact	Transitioning for real-world impact	Upside and downside risk **(incl. Legitimacy)**
ESG-related challenges and obstacles	ESG-related challenges and obstacles	ESG-related challenges and obstacles	Transparency towards stakeholders
Long-termism	Long-termism	Long-termism	**2. IMPLICIT AND EXPLICIT ESG**
Determination	Determination	Determination	ESG - a natural extension **(incl. Determination)**
Fiduciary Responsibility	Fiduciary Responsibility	Fiduciary Responsibility	ESG-integration into the investment process
Upside and downside risk	Upside and downside risk	Upside and downside risk	**3. UNITED INVESTOR ACTION**
Multi-level engagement	Multi-level engagement	Multi-level engagement	Developing a common ground
Capital as power	Capital as power	Capital as power	Borderless collaboration
Legitimacy	Legitimacy	Legitimacy	Capital as power
AOA - a natural extension	**ESG - a natural extension**	ESG - a natural extension	4. TRANSITIONING FOR REAL-WORLD IMPACT
Transparency towards stakeholders	Transparency towards stakeholders	Transparency towards stakeholders	ESG-related challenges and obstacles
Divestment as a last resort	**Divestment decisions**	Divestment decisions	Multi-level engagement
	Shifting mindsets	Shifting mindsets	Divestment decisions

This table presents the development of concepts during the analysis process using the QUAGOL-method. In the occasions where concepts have been added or redefined in a step, this concept is in bold in that specific step.

References

Bénabou, R. & Tirole, J. (2010). Individual and Corporate Social Responsibility. *Economica*, 77(305), pp.1-19.

Blackrock. (2014). *Who owns the assets?* [online] Retrieved: 2020-06-03. Available at: https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-who-owns-the-assets-may-2014.pdf

Cai, Y., Jo, H. & Pan, C. (2012). Doing Well While Doing Bad? CSR in Controversial Industry Sectors. *Journal of Business Ethics*, 108(4), pp.467-480.

Cambridge Dictionary. (n.d.). *Institutional investor*. [online] Retrieved: 2020-06-03. Available at: https://dictionary.cambridge.org/dictionary/english/institutional-investor

Clark, G. & Hebb, T. (2005). Why should they care? The role of institutional investors in the market for corporate global responsibility. *Environment and Planning A*, 37(11), pp.2015-2032.

Dierckx de Casterlé, B., Gastmans, C., Byron, E. & Denier, Y. (2012). QUAGOL: A guide for qualitative data analysis. *International Journal of Nursing Studies* 49, (2012), pp.360–371.

DiMaggio, P. T. & Powell, W. W. (1983). The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields. *American Sociological Review*, Vol. 48, No. 2, pp.147-160.

Dul J. & Hak T. (2008). *Case Study Methodology in Business Research*. Taylor and Francis, UK.

Eisenhardt, K. M. (1989). Building theories from case study research. *Academy of Management Review*, 14(4), pp.532-550.

Eurosif. (2018). *European SRI Study 2018* [online] Retrieved: 2020-05-30. Available at: http://www.eurosif.org/wp-content/uploads/2018/11/European-SRI-2018-Study-LR.pdf

Financial Reporting Council. (2020). *The UK Stewardship Code 2020.* The Financial Reporting Council Limited 2020. [online] Retrieved: 2020-05-22. Available at: https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf

Freshfields Bruckhaus Deringer. (2005). *A legal framework for the integration of environmental, social and governance issues into institutional investment.* Produced for the Asset Management

Working Group for the UNEP Financial Initiative. October 2005. [online] Retrieved: 2020-01-13. Available at: https://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf

Froggatt, K. (2001). The analysis of qualitative data: Processes and pitfalls. *Palliative Medicine,* 15(5), pp.433-438.

Gifford, E. (2010). Effective Shareholder Engagement: The Factors that Contribute to Shareholder Salience. *Journal of Business Ethics*, 92(Supplement 1), pp.79-97.

Goodman, J., Louche, C., Cranenburgh, K. & Arenas, C. (2014). Social Shareholder Engagement: The Dynamics of Voice and Exit. *Journal of Business Ethics*, 125(2), pp.193-210.

Hamilton, I. & Eriksson, J. (2011). Influence strategies in shareholder engagement: A case study of all Swedish national pension funds. *Journal of Sustainable Finance & Investment*, 1(1), pp.44-61.

Hawley, J. & Williams, A. (2002). The Universal Owner's Role in Sustainable Economic Development. *Corporate Environmental Strategy*, 9(3), pp.284-291.

Hawley, J. & Williams, A. (2007). Universal Owners: Challenges and opportunities. *Corporate Governance: An International Review*, 15(3), pp.415-420.

Hmaittane, A., Bouslah, K. & M'zali, B. (2019). Does corporate social responsibility affect the cost of equity in controversial industry sectors? *Review of Accounting and Finance*, 18(4), pp.635-662.

Hoepner, A. G. F., Rezec, M. & Siegl, K. S. (2011). Does Pension Funds' Fiduciary Duty Prohibit the Integration of Environmental Responsibility Criteria in Investment Processes? A Realistic Prudent Investment Test. Available at: SSRN: https://ssrn.com/abstract=1930189 or http://dx.doi.org/10.2139/ssrn.1930189

Hong, H. & Kacperczyk, M. (2009). The price of sin: The effects of social norms on markets. *Journal of Financial Economics*, 93(1), pp.15-36.

Hunter, A., Lusardi, P., Zucker, D., Jacelon, C. & Chandler, G. (2002). Making Meaning: The Creative Component in Qualitative Research. *Qualitative Health Research,* 12(3), pp.388-398.

Jansson, M., Sandberg, J., Biel, A. & Gärling, T. (2014). Should pension funds' fiduciary duty be extended to include social, ethical and environmental concerns? A study of beneficiaries' preferences. *Journal of Sustainable Finance & Investment*, 4(3), pp.213-229.

Krueger, P., Sautner, Z. & Starks, L. T. (2019). The Importance of Climate Risks for Institutional Investors. *ECGI Working Paper Series in Finance no. 610/2019. Swiss Finance Institute Research Paper Series* no. 18-58.

Manning, B., Braam, G. & Reimsbach, D. (2018). Corporate governance and sustainable business conduct—Effects of board monitoring effectiveness and stakeholder engagement on corporate sustainability performance and disclosure choices. *Corporate Social Responsibility and Environmental Management*, 26(2), pp.351-366.

O'Rourke, A. (2003). A new politics of engagement: Shareholder activism for corporate social responsibility. *Business Strategy and the Environment*, 12(4), pp.227-239.

Regeringskansliet. (2020). *Ändring i Finansinspektionens instruktion – finansiella systemet ska bidra till hållbar utveckling*. Press release, 2020-01-16. [online] Retrieved: 2020-02-21. Available at: https://www.regeringen.se/pressmeddelanden/2020/01/andring-i-finansinspektionens-instruktion--finansiella-systemet-ska-bidra-till-hallbar-utveckling/

Richardson, B. J. (2011). Fiduciary Relationships for Socially Responsible Investing: A Multinational Perspective. *American Business Law Journal*, 48, pp.597-775.

Richardson, B. J. (2013). Socially Responsible Investing for Sustainability: Overcoming Its Incomplete and Conflicting Rationales. *Transnational Environmental Law*, 2(2), pp.311-338.

Richardson, B. J. & Peihani, M. (2015). Universal investors and socially responsible finance: A critique of a premature theory. *Banking & Finance Law Review*, 30(3), pp.405-455.

Riksdagen. (2007). *AP-fondernas riktlinjer för miljö och etik m.m*. Kommittédirektiv 2007:160. [online] Retrieved: 2020-02-20. Available at: https://www.riksdagen.se/sv/dokument-lagar/dokument/kommittedirektiv/ap-fondernas-riktlinjer-for-miljo-och-etik-mm_GVB1160

Schanzenbach, M. M. & Sitkoff, R. H. (2019). Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee. *Stanford Law Review, Forthcoming; Northwestern Law & Econ Research Paper* No. 18-22; *Harvard Public Law Working Paper No*. 19-50. http://dx.doi.org/10.2139/ssrn.3244665

Sandberg, J. (2011). Socially Responsible Investment and Fiduciary Duty: Putting the Freshfields Report into Perspective. *Journal of Business Ethics*, 101(1), pp.143-162.

Sandberg, J. (2013). (Re-)Interpreting Fiduciary Duty to Justify Socially Responsible Investment for Pension Funds? *Corporate Governance: An International Review*, 21(5), pp.436-446.

SDGs. (n.d.). SDGs - Sustainable Development Goals. [online] Retrieved: 2020-01-13. Available at: https://sustainabledevelopment.un.org/sdgs

Sjöström, E. (2020). Active ownership on environmental and social issues: What works? A summary of the recent academic literature. *Mistra Center for Sustainable Markets, Stockholm*.

Sveriges Riksdag. (2010). *Försäkringsrörelselag (2010:2043).* [online] Retrieved: 2020-05-18. Available at: https://www.riksdagen.se/sv/dokument-lagar/dokument/svensk-forfattningssamling/forsakringsrorelselag-20102043_sfs-2010-2043

Sveriges Riksdag. (2019). *Lag (2019:742) om tjänstepensionsföretag*. [online] Retrieved: 2020-05-18. Available at: https://www.riksdagen.se/sv/dokument-lagar/dokument/svensk-forfattningssamling/lag-2019742-om-tjanstepensionsforetag_sfs-2019-742

The net-zero asset owner alliance. (2019). *Brochure*. [online] Retrieved: 2020-02-07. Available at: https://www.unepfi.org/wordpress/wp-content/uploads/2019/09/AOAbrochure.pdf

Thornton, P. (2004). *Markets from Culture: Institutional Logics and Organizational Decisions in Higher Education Publishing*. Stanford, CA: Stanford University Press.

UN. (1987). *Report of the World Commission on Environment and Development - Our Common Future*. General Assembly. [online] Retrieved: 2020-01-10. Available at: https://www.un.org/ga/search/view_doc.asp?symbol=A/42/427&Lang=E

UN PRI. (n.d.). *About the PRI - What is responsible investment?* [online] Retrieved: 2019-12-29. Available at: https://www.unpri.org/pri/an-introduction-to-responsible-investment/what-is-responsible-investment

UN PRI. (2020). *PRI welcomes 500th asset owner signatory.* By Saa, L. 2020-01-27. [online] Retrieved: 2020-02-14. Available at: https://www.unpri.org/pri-blog/pri-welcomes-500th-asset-owner-signatory/5367.article

UNEP FI. (n.d). *UN-convened Net-Zero Asset Owner Alliance*. [online] Retrieved: 2020-02-13 Available at: https://www.unepfi.org/net-zero-alliance/

UNEP FI. (2009). *Fiduciary responsibility – legal and practical aspects of integrating environmental, social and governance issues into institutional investment.* [online] Retrieved: 2020-02-14. Available at: https://www.unepfi.org/publications/investment-publications/fiduciary-responsibility-legal-and-

practical-aspects-of-integrating-environmental-social-and-governance-issues-into-institutional-investment/

UNFCC. (2015). *Paris Agreement*. [online] Retrieved: 2020-05-22. Available at: https://unfccc.int/files/meetings/paris_nov_2015/application/pdf/paris_agreement_english_.pdf

Wen, S. (2009). Institutional investor activism on socially responsible investment: Effects and expectations. *Business Ethics: A European Review*, 18(3), pp.308-333.

World Economic Forum. (2019). *The Global Risks Report 2019, 14th Edition*. WEF in Partnership with Marsh & McLennan Companies and Zurich Insurance Group. [online] Retrieved: 2019-12-17. Available at: http://www3.weforum.org/docs/WEF_Global_Risks_Report_2019.pdf

Yin, R. (2014). *Case study research: Design and methods,* 5th edition. SAGE Publications Inc.