

Do the Fiduciary Duties of Pension Funds Hinder Socially Responsible Investment?

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In recent years, pension funds and other institutional investors have begun to give more attention to the environmental and social behaviour of the companies in which they invest. A recent movement for socially responsible investment (SRI) seeks to exclude companies that pollute or ignore human rights, for example, and to champion those that behave ethically and responsibly. However, some confusion among investment decision-makers persists about the extent to which their fiduciary duties to beneficiaries allow policies that may sacrifice financial returns for environmental or other philanthropic causes. This is compounded by the belief that they cannot secure the best returns in respect of their fiduciary obligations with current socially responsible companies. With reference to the main common law jurisdictions, this article critically examines whether the fiduciary duties of pension fund investors hinder SRI. Contrary to some commonly held beliefs, SRI can often sit comfortably with fiduciary duties to invest prudently. However, legal reforms to improve the climate for SRI would help, as evident by some recent initiatives in several jurisdictions.

Depuis quelques années, les caisses de retraite et les autres investisseurs institutionnels sont plus sensibles au comportement environnemental et social des sociétés dans lesquelles ils investissent. Un mouvement récent en faveur de l'investissement socialement responsable (l'ISR) vise à exclure par exemple, des sociétés qui polluent ou celles qui négligent les droits de l'homme et à privilégier plutôt celles qui adoptent un comportement éthique et responsable. Toutefois, il persiste une certaine confusion parmi les décideurs en matière de placement qui se demandent dans quelle mesure leurs obligations fiduciaires leur permettent d'adopter des politiques qui sacrifieraient des rendements financiers pour des causes environnementales ou d'autres causes philanthropiques. Cette confusion est aggravée par la crainte de ne pouvoir obtenir les meilleurs rendements, conformément à leurs obligations fiduciaires, dans le cadre de placements dans les sociétés socialement responsables actuelles. En rapport avec les principales juridictions de common law, l'auteur analyse cette question de savoir si les obligations fiduciaires des investisseurs de caisses de retraite constituent une entrave à l'ISR. Contrairement à certaines opinions généralement répandues, il est d'avis que l'ISR cadre souvent bien avec les obligations fiduciaires d'investir de manière prudente.

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En revanche, des réformes juridiques visant l'amélioration de l'ambiance de l'ISR seraient utiles, comme le prouvent certaines initiatives récentes ayant été mises en œuvre dans plusieurs juridictions.

Table of Contents

1.	INTRODUCTION	147
2.	FIDUCIARY INVESTMENT STANDARDS	150
	(a) The Fiduciary Relationship	150
	(b) Evolution of Fiduciary Investor Standards	152
3.	IMPLICATIONS OF FIDUCIARY INVESTOR STANDARDS FOR SRI	160
	(a) Accommodating Non-Financial Benefits	160
	(b) Fiduciary Obligations in the Context of SRI Policies	165
4.	PENSION FUNDS	169
	(a) Basic Principles	169
	(b) UK Case Law	173
	(c) US Pension Funds	178
	(d) Australian Superannuation Funds	181
	(e) Conclusions	185
5.	REFORMING FIDUCIARY RESPONSIBILITIES FOR SRI	185
	(a) Underlying Principles	185
	(b) SRI as a “Material” or Discretionary Concern	188
	(c) The Disclosure Approach	190
	(d) Compulsory SRI	193
	(e) Other Incidental Reforms	197
6.	CONCLUSION: THE FUTURE OF INVESTORS’ FIDUCIARY DUTIES	199

1. INTRODUCTION

Do the fiduciary obligations of pension funds currently hinder socially responsible investment (SRI)? Trustees of pension funds charged with the investment of funds on behalf of others are legally obliged to act prudently and loyally in the best interests of their beneficiaries. Some investors and lawyers believe that these obligations restrict pension funds from taking non-financial criteria into account.¹ This is because, absent a specific mandate to invest ethically, they believe an investment intermediary must choose investments that maximize financial returns for beneficiaries. A fiduciary who breaches prudent investment standards is liable to compensate beneficiaries for losses attributable to this breach of duty.²

No authoritative or societal agreement exists on what constitutes “socially responsible investment”. For the purposes of my analysis, I treat SRI generally as an investment process that considers the social, environmental and ethical consequences of investments, both positive and negative. In recent years, a stronger demand for SRI has emerged in Western financial markets. It has been attributed to various factors, including investor awareness of the positive correlation between corporate environmental and financial performance. There are also external pressures from non-governmental groups fuelling public opinion through the media, demanding that companies and their financiers act more responsibly.³

Socially responsible investment may be achieved through several methods. Primarily, ethical investors use positive and/or negative screens.⁴ A negative screen excludes companies involved in questionable activities (*e.g.*, nuclear power or pesticides manufacture) while a

¹ J.D. Hutchinson & C.G. Cole, “Legal Standards Governing Investment of Pension Assets for Social and Political Goals” (1980) 128(4) U. Pa. L. Rev. 1340; P. Ali & K. Yano, *Eco-Finance* (The Hague: Kluwer, 2004) 128-40; J.H. Langbein & R.A. Posner, “Social Investing and the Law of Trusts” (1980) 79 Mich. L. Rev. 72.

² L. Ho, “Attributing Losses to a Breach of Fiduciary Duty” (1998) 12 Trust L. Int’l 66.

³ See P.C. Hunt (ed.), *Values to Value: A Global Dialogue on Sustainable Finance* (Geneva: United Nations Environment Programme Finance Initiative, 2004); E.G. Geltman & A.E. Skroback, “Environmental Activism and the Ethical Investor” (1997) 22(3) J. Corp. L. 465; J.J. Bouma, M.H.A. Jeucken & L. Klinkers (eds.), *Sustainable Banking: The Greening of Finance* (Sheffield: Greenleaf Publishing, 2001).

⁴ R. Sparkes, *The Ethical Investor* (London: HarperCollins, 1995).

positive screen selects firms engaged in desirable practices (*e.g.*, renewable energy supply). “Best of sector” is another popular SRI method, by which those companies that perform best in their industry sector are selected for investment, as measured against specified socially responsible indicators. An “index-based” method of SRI by contrast constructs investment portfolios through established indices of environmentally and socially responsible companies, such as the Dow Jones Sustainability Group Index.⁵ Some financiers address social and environmental issues only when they are perceived as financially material to their client portfolios. This is a less direct form of SRI investing, followed when it promises a financial benefit (either through investment performance or growing market demand) or avoids a financial risk to investors (either large environmental fines or negative publicity). Finally, investors may use corporate engagement and shareholder activism, in combination with the above methods or as a separate strategy, to influence corporate policies.⁶

The SRI sector is a small segment of capital markets. For example, in Western Europe, this sector holds about three to four percent of both wholesale and retail investment markets.⁷ The United States, boasting the largest SRI sector, held US\$2.29 trillion in SRI assets (2005) or “nearly one out of every ten dollars under professional management...”.⁸ A 2004 survey of Canadian SRI found the sector to be worth C\$51.4 billion, amounting to 3.3 percent of the total investment market.⁹ By comparison, the Australian SRI sector held just 1.14 percent (2005) of all assets under management.¹⁰ All such studies must be cautiously compared due to different definitions and methodologies in each country measuring SRI.

⁵ See online: <www.sustainability-indexes.com>.

⁶ *E.g.*, A.K. Prevost & R.P. Rao, “Of What Value are Shareholder Proposals Sponsored by Public Pension Funds?” (2000) 73(2) *Journal of Business* 177.

⁷ Avanzi SRI Research, *Green, Social and Ethical Funds in Europe 2004* (Milan: SIRI Group, 2004); European Social Investment Forum (EUROSIF), *Socially Responsible Investment among European Institutional Investors* (Paris: EUROSIF, 2003).

⁸ Social Investment Forum (SIF), *2005 Report on Socially Responsible Investing Trends in the United States: A 10-Year Review* (SIF, January 2006) iv.

⁹ Social Investment Organization (SIO), *Canadian Social Investment Review 2004* (Toronto: SIO, 2005).

¹⁰ Corporate Monitor, *Sustainable Responsible Investment in Australia – 2005* (Sydney: Ethical Investment Association, 2005) 12.

Various economic, institutional and legal factors hinder the expansion of the SRI market beyond its relatively small niche. This article posits that fiduciary obligations of investment managers number among some of the legal barriers to SRI as a mainstream investment practice. A recent study on capital markets undertaken for Canada's National Round Table on the Environment and the Economy concluded: "current interpretations of the fiduciary duties of pension fund managers may unnecessarily constrain their ability to address the full range of relevant corporate responsibility considerations related to prospective investments".¹¹ Conversely, a United Nations Environment Programme (UNEP) report (2005) concluded that investment managers' fiduciary duties should not necessarily preclude or overly hamper SRI.¹²

From the assumption that we should encourage SRI to promote a more sustainable economy, this article provides a doctrinal exegesis of fiduciary investment duties while evaluating whether they hinder SRI. The analytical focus is the fiduciary duties of pension funds in selected common law jurisdictions, namely Australia, Canada, New Zealand, the United Kingdom (UK) and the United States (US). It does not consider investment standards governing other types of institutional investment managers (*e.g.*, insurance companies or mutual funds). Nor does it examine legal developments in other, non-common law jurisdictions.¹³ Contrary to common perceptions on the subject, SRI does not always or necessarily conflict with fiduciary duties of pension funds. Moreover, fulfilling fiduciary obligations can actually require careful attention to corporate social and environmental performance. The article concludes by evaluating reforms to fiduciary duties and ancillary standards in concert with promoting the growth of SRI.

¹¹ Stratos Inc., *Corporate Disclosure and Capital Markets* (Ottawa: National Round Table on the Environment and the Economy, 2004) 12.

¹² Freshfields Bruckhaus Deringer, *A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment* (Geneva: UNEP Finance Initiatives October 2005).

¹³ Some analysis of investors' responsibilities in these jurisdictions is given in the Freshfields Bruckhaus Deringer study, *ibid.*

2. FIDUCIARY INVESTMENT STANDARDS

(a) The Fiduciary Relationship

Shorn of context-specific labels, a fiduciary relationship is generally a relationship of responsibility and dependency.¹⁴ Fiduciary relationships arise “when one party (the ‘fiduciary’) acts on behalf of another party (the ‘beneficiary’) while exercising discretion with respect to critical resources belonging to the beneficiary”.¹⁵ In this relationship, beneficiaries – or dependant parties – rely upon the fiduciary to manage some aspect of their personal or economic affairs over which the fiduciary has control and responsibility.

Two features of this fiduciary relationship are notable. First, considerable discretionary power is vested in the fiduciary. This discretion is exercised within broad parameters of care and loyalty that bind the fiduciary’s authority. Second, typically the beneficiary has been precluded from exercising any control over that area. These principal elements of the fiduciary relationship inform specific legal duties.

Consequential to the powers afforded them, fiduciaries must act in the dependant’s interests, and not their own. As such, the fiduciary’s foremost duty is one of loyalty to the beneficiary – to act in their sole or best interests.¹⁶ As pension trustees are fiduciaries, this principle is behind the prohibitions on engaging in conflict-of-interest transactions adverse to the interests of pension plan members.¹⁷ In the management of an investment portfolio, the fiduciary must also exercise due care, diligence, and skill. These standards coalesce to form the twin key duties of loyalty and prudence, the latter known as the “prudent person rule” or “prudent investor rule”.¹⁸

¹⁴ See generally R. Flannigan, “The Boundaries of Fiduciary Accountability” (2004) N.Z.L. Rev. 215; J.C. Shepherd, “Towards a Unified Concept of Fiduciary Relationships” (1981) 97 Law Q. Rev. 51.

¹⁵ D.G. Smith, “The Critical Resource Theory of Fiduciary Duty” (2002) 55 Vand. L. Rev. 1399 at 1483.

¹⁶ Hutchinson & Cole, *supra*, n. 1 at 1367; J. Langbein, “Questioning The Trust Law Duty of Loyalty: Sole Interest or Best Interest?” (2005) 114 Yale L.J. 929.

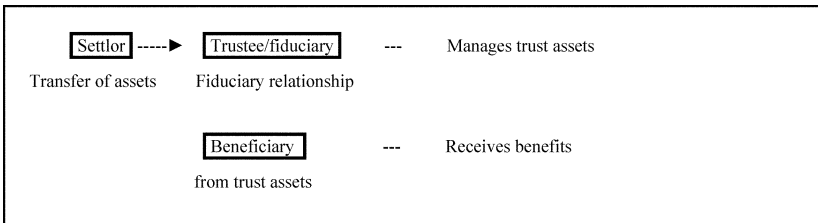
¹⁷ A. Hudson, *The Law on Investment Entities* (London: Sweet and Maxwell, 2000) at 85-86.

¹⁸ See generally B. Longstreth, *Modern Investment Management and the Prudent Man Rule* (New York: Oxford University Press, 1986).

Fiduciary responsibilities can arise in various ways. In common law jurisdictions, they occur in relationships that are presumptively fiduciary such as trustee-beneficiary. The “trust” is a concept of English law by which specific assets are constituted and managed by trustees for the benefit of the beneficiary.¹⁹ The entity (*e.g.*, an individual or a corporation) that creates the trust is called the settlor.

The equitable notion of a fiduciary relationship arose because traditionally the beneficiary had no right recognized in common law. The English courts of equity began to acknowledge the beneficiary’s interest and imposed a responsibility upon the fiduciary to protect that interest.²⁰ Trusts are widely used as a means of corporate financing, in both pension plans and mutual funds.²¹ Sometimes the factual circumstances of a relationship also engender fiduciary obligations, such as a relationship between investment advisor and client.²²

Basic Structure of a Trust Arrangement



¹⁹ See D.J. Hayton, “The Irreducible Core Content of Trusteeship” in A.J. Oakley (ed.), *Trends in Contemporary Trust Law* (Oxford: Clarendon Press 1996), 47; A. Hudson, *Principles of Equity and Trusts* (London: Cavendish, 1999); Hudson, *supra*, n. 17 at 66-74; D. Hayton, “English Fiduciary Standards and Trust Law” (1999) 32 Vand. J. Transnat’l L. 555; D. DeMott, “Beyond Metaphor: An Analysis of Fiduciary Obligation” (1988) Duke L.J. 879.

²⁰ In countries without a trust concept, contract law for example may be used to impose prudent investor standards.

²¹ P. O’Hagan, “The Use of Trusts in Finance Structures” (2000) 8(2) Journal of International Trust and Corporate Planning.

²² According to Clarke, the only difference between these two situations is the onus of proof: “In traditional relationships a fiduciary relationship is assumed and the onus is on the defendant to demonstrate otherwise. In fact-based fiduciary relationships, which includes the relationships between [investment advisors] and their clients, the onus is on the plaintiff client to establish that a fiduciary relationship existed”. G.A. Clarke, *Liability and Damages in Unsuitable Investment Advice Cases* (Toronto: Fasken Martineau DuMoulin LLP, 2005).

The prudent investor rule, as shown later in this article, is particularly significant for SRI. The rule evolved through case law, supplemented by statutory provisions that generally altered it to accommodate the more contemporary practices of institutional investment and the dynamics of modern capital markets.²³ Such regulation sometimes imposes quantitative restrictions on the type and size of investment assets in a portfolio.²⁴

The prudent investor rule addresses the behaviour of fiduciaries rather than results of investment decisions. The prudent investor rule presumes that any investment is permissible without any prohibition, if selected with care and prudence. Thus, fiduciaries are not judged by historical financial performance, but by the reasonableness of their decision-making process.

In particular, trustees or fiduciaries are expected to have adequate skill with investing and to exercise due care in fulfilling their tasks (the duty of competence). Often this results in the need for fiduciaries to seek expert advice and to delegate various activities to those with requisite skill.²⁵ Another standard commonly connected to the prudent investor rule is the principle of diversification. A fiduciary should avoid speculative and unduly risky investments,²⁶ and a diverse portfolio can minimize investment risk.

(b) Evolution of Fiduciary Investor Standards

Fiduciary investor standards have evolved over time and now vary slightly in each jurisdiction. There may even be varying standards in different economic sectors within a single jurisdiction (*e.g.*, between pension plans and charitable trusts).

²³ J.H. Langbein, "The Secret Life of the Trust: The Trust as an Instrument of Commerce" (1997) 107 Yale L.J. 165.

²⁴ Organisation for Economic Cooperation and Development (OECD), *Survey of Investment Regulations of Pension Funds* (Paris: OECD, 2001); E.P. Davis, *Portfolio Regulation of Life Insurance Companies and Pension Funds*, Discussion Paper PI-0101 (London: The Pensions Institute, City University, 2001).

²⁵ Hayton, *supra*, n. 19 at 562-63.

²⁶ But see M.T. Johnson, "Speculating on the Efficacy of 'Speculation': An Analysis of the Prudent Person's Slipperiest Term of Art in Light of Modern Portfolio Theory" (1996) 48 Stan. L. Rev. 419.

The conception of trusts in the 18th century was a means of protecting family wealth over succeeding generations.²⁷ The prudent investor rule emphasized risk aversion and preserving capital rather than asset growth and prohibiting delegation of investment decisions. In 1720, the South Sea Company collapsed, in which trust assets were invested and suffered great financial loss. As a result, British authorities legislated to restrict trustees to a limited list of allowable investments.²⁸ Fiduciary obligation, it appears, was measured in the preservation of the beneficiaries' capital. In time, the list lengthened due to market forces, but the notion that certain types of asset classes (*e.g.*, equities) might be inherently imprudent persisted for centuries afterwards. This approach was followed in other common law jurisdictions, each enforcing prohibited lists of their own.

Historically, fiduciaries were expected to evaluate risks and returns of each individual investment rather than evaluating the overall performance of a portfolio.²⁹ In the US case of *King v. Talbot*,³⁰ the prudent investor rule was interpreted conservatively as prohibiting "speculative" investing *per se*, emphasizing a duty to preserve the trust's capital. The suitability of investments had to be assessed strictly on a case-by-case basis.³¹ As stated, it would thus be impermissible to offset that specific risk with another investment in the context of the entire portfolio.

Some commentators have extrapolated that the traditional formulation of the prudent investor standard effectively precluded any socially responsible investments that posed unusual risk, as each would need to be assessed and justified on their own terms.³²

The traditional prudent investor prescriptions run contrary to maximizing performance of modern investment funds, where the cyclicity

²⁷ On the roots of trusts, see Hudson, *supra*, n. 17.

²⁸ On this episode, see J. Carswell, *The South Sea Bubble* (London: Cresset Press, 1960).

²⁹ See generally A.W. Scott & W.F. Fletcher, *The Law of Trusts* (Boston: Little, Brown and Co., 1988).

³⁰ 40 N.Y. 76 (1869). See also the US case of *Harvard College v. Amory*, 26 Mass. 454 (1830) and the British case of *Whiteley, Re* (1886), 33 Ch. D. 347 (Eng. C.A.).

³¹ US law on the prudent investor rule changed little until the 1980s: see J.N. Gordon, "The Puzzling Persistence of the Constrained Prudent Man Rule" (1987) 62 N.Y.U.L. Rev. 52.

³² Ali & Yano, *supra*, n. 1 at 131.

of investments mandate diversification to spread risk. Consequently, modern portfolio theory (MPT) has redefined the prudent investor rule.³³ The MPT evaluates investments not in isolation, but rather by their contribution on the performance objectives and risk profile of the entire portfolio.³⁴ By emphasizing the portfolio as a whole rather than the individual components (the whole is greater than the sum of its parts), diversification is at the heart of MPT. The theory suggests that a portfolio can offer a higher rate of return with lower overall risk than suggested by the mere sum of its parts, where investments are combined that do not correlate or correlate negatively (*i.e.*, their market prices do not move in tandem) to each other. Thus, while an individual ethical investment in a new environmental technology business might seem in isolation too risky, in combination with other investments it may constitute a prudent investment for a fiduciary.³⁵

The MPT has shaped a reformulation of the prudent investor rule in several jurisdictions through statutory reform and judicial activism. The traditional onus to seek the highest return on each individual investment has deferred to a duty to adopt an investment strategy that incorporates sound risk and return objectives over the entire trust portfolio. Concomitantly, legislation has freed trustees from the restrictions of the laundry list of permissible investments. In the UK, the High Court in *Nestle v. National Westminster Bank* held:

Modern trustees acting within their investment powers are entitled to be judged by the standards of current portfolio theory, which emphasizes the risk level of the entire portfolio rather than the risk attaching to each investment taken in isolation.³⁶

Both the UK's *Pensions Act 1995* and the *Trustee Act 2000* reflect such investment standards.³⁷

³³ P.G. Haskell, "The Prudent Person Rule For Trustee Investment and Modern Portfolio Theory" (1990) 69 N.C.L. Rev. 87.

³⁴ F.J. Fabozzi, F. Gupta & H.M. Markowitz, "The Legacy of Modern Portfolio Theory" (2002) 11(3) Journal of Investing 7.

³⁵ However, in theory the negation of risk arises because another investment (in the diverse portfolio) offsets the environmentally focused company's risks – where its objectives by nature may run contrary to the purposes of the new environmental technology – and thereby perhaps defeating the SRI purpose.

³⁶ (1996), 10 T.L.I. 111 at 115 (per Hoffman J.).

³⁷ *Pensions Act 1995*, s. 36(2)(a) and (b), and *Trustee Act 2000*, s. 4(1), 3(a)-(b).

A similar transformation of investment duties has emerged in the US. The prudent investor rule appears in federal statutes (notably, the *Employee Retirement Income Security Act* (ERISA) 1974), state statutes implementing uniform laws or through state common law often with reference to the American Law Institute's (ALI) *Third Restatement of Trusts (Prudent Investor Rule)*. The ALI's enunciation of the prudent investor rule requires fiduciaries to:

- assess investments not in isolation but by reference to their contribution to the whole investment portfolio;
- rather than merely seek to “maximize” the return of individual assets, to implement a holistic investment strategy that is rational and appropriate to the fund;
- create a diverse investment portfolio; and
- judge the prudence of an investment at the time the investment was selected rather than by hindsight.³⁸

For US non-government pension plans,³⁹ the ERISA takes a whole portfolio approach to asset management.⁴⁰ The US Department of Labor specifically clarified that the statutory standard means that the “prudence of a particular investment decision should not be judged without regard to the role that the proposed investment or investment course of action plays within the overall portfolio”.⁴¹

An equivalent legal position exists in Canada.⁴² The model *Uniform Trustee Investment Act 1997*, which has shaped trustee legislation in nearly all of the common law provinces, provides for the replacement of the traditional formulation of the prudent investor rule with an MPT-based standard. When investing trust funds, the Act requires a fiduciary

³⁸ American Law Institute (ALI), *Restatement (Third) of the Law Trusts: Prudent Investor Rule* (Washington DC: ALI, 1990) 8 (section 227). See further, E.C. Halbach, “Trust Investment Law in the Third Restatement” (1992) *Iowa L. Rev.* 1151; R.J. Aalberts & P.S. Poon, “The New Prudent Investor Rule and the Modern Portfolio Theory: A New Direction for Fiduciaries” (1996) *34 Am. Bus. L.J.* 39.

³⁹ Although ERISA does not apply to government pension plans such as the Employees’ Retirement System, some states have legislated the prudent investor rule as their fiduciary standard for their state pension fund trustees.

⁴⁰ ERISA, s. 404 sets forth the general standards of fiduciary conduct.

⁴¹ *29 US Code of Federal Regulations*, s. 2550.404a-1(b).

⁴² See D.W.M. Waters, *Law of Trusts in Canada* (Toronto: Carswell, 2005).

to have regard to the circumstances of the trust, including “the role that each investment or course of action plays within the overall trust portfolio”.⁴³ Canadian courts have unequivocally affirmed that pension funds are subject to trust law precepts, as clarified by statute.⁴⁴ Prudential investment standards from trust law are articulated in Canadian provincial and federal legislation, albeit not entirely consistently.⁴⁵ Further, the *Federal Investment Rules of 1993* modernized the regulation of pension fund investment by abandoning the previous legal list approach that rigidly specified permissible classes of investments.⁴⁶

New Zealand’s *Trustee Act 1956* was amended in 1988 to introduce, to some extent, more modern investment principles.⁴⁷ Private pension plans are governed by the *Superannuation Schemes Act 1989*. New Zealand has relatively few occupational pension funds because the taxation benefits that have enabled such funds to flourish in other jurisdictions are non-existent.⁴⁸ Its *Superannuation Schemes Act* stipulates that pension plan assets must be invested in accordance with the *Trustee Act 1956*.⁴⁹ Recent case law there confirms that courts are taking a different

⁴³ *Uniform Trustee Investment Act 1997*, s. 01(3)(c). The Act was prepared by the Uniform Law Conference of Canada for adoption by Canadian governments.

⁴⁴ See, e.g., *Bathgate v. National Hockey League Pension Society* (1994), 16 O.R. (3d) 761, 1994 CarswellOnt 643, 1 C.C.P.B. 209, 69 O.A.C. 269, 2 C.C.E.L. (2d) 94, 110 D.L.R. (4th) 609, 2 E.T.R. (2d) 1 (Ont. C.A.) at 776 [O.R.]; leave to appeal refused (1994), 4 E.T.R. (2d) 36, 4 C.C.P.B. 272 (note) (S.C.C.); *Boe v. Alexander* (1987) 41 D.L.R. (4th) 520, 1987 CarswellBC 182, 15 B.C.L.R. (2d) 106, 41 D.L.R. (4th) 520, 28 E.T.R. 228 (B.C. C.A.) at 526–27 [D.L.R.]; leave to appeal refused (1988), 43 D.L.R. (4th) vii, 87 N.R. 299 (note), 22 B.C.L.R. (2d) xxx, 28 E.T.R. xxxvi (S.C.C.). See further T.G. Youdan, *Equity, Fiduciaries and Trusts* (Scarborough: Carswell, 1989).

⁴⁵ See especially G. Yaron, “The Responsible Pension Trustee: Re-Interpreting the Principles of Prudence and Loyalty in the Context of Socially Responsible Institutional Investing” (2001) 20 E.T.P. J. 305.

⁴⁶ These regulations were made under the *Pension Benefits Standards Act 1985*.

⁴⁷ Incorporated into ss. 13B and 13E; for analysis, see A. Butler, “Modern Portfolio Theory and Investment Powers of Trustees: The New Zealand Experience” (1995) 7 Bond Law Review 119.

⁴⁸ L. Marriott & C. Fowler, *From Social Policy to Economic Policy: Taxation Incentives for Retirement Income Savings in New Zealand (1910-2005)*, Working Paper No. 18 (Wellington: School of Accounting and Commercial Law, Victoria University of Wellington, 2005) 22.

⁴⁹ Section 8(a).

view of prudent investment standards.⁵⁰ In *Mulligan, Re*,⁵¹ the New Zealand High Court held that the trustee's duty to act with due diligence and prudence was flexible and should reflect changing economic conditions and contemporary investment philosophies.

During the 1990s, all Australian jurisdictions followed New Zealand and abolished the old legal list of authorized trustee investments, giving trustees plenary investment power.⁵² The trustee statutes contain significant allusions to the precepts of MPT that inform the US *Third Restatement of Trusts (Prudent Investor Rule) 1992*, including: the desirability of diversifying trust investments, and the potential for capital appreciation.⁵³

However, both Australian and New Zealand trustee legislation arguably contain provisions redolent of earlier concepts of prudential investment. Ali and Yano, who have studied these jurisdictions closely, are critical of the statutes' retention of an arguably artificial distinction between prudent and speculative investments, as well as duties to preserve the capital and income of the trust, and to take account of the risk of capital or income.⁵⁴ Recent case law tends to confirm that Australian courts still view trusts as governed by traditional norms of investment management.⁵⁵

For occupational pension plans, Australia's *Superannuation Industry (Supervision) Act 1993* contains no such ambiguities and allows trustees of pension funds to invest according to modern investment practices. The Act provides that trustees of pension funds must:

... formulate and give effect to an investment strategy that has regard to the whole of the circumstances of the [fund] including, but not limited to, the following:

⁵⁰ See E.P. Manns, Jr., "New Zealand Trustee Investing: Reflecting on Modern Portfolio Theory and the Ancient Distinction of Principal and Income" (1998) 28(4) V.U.W.L.R. 611.

⁵¹ [1998] 1 N.Z.L.R. 481 (New Zealand H.C.).

⁵² E.g., *New South Wales (Trustee Amendment (Discretionary Investments) Act 1997*; *Queensland (Trustee (Investments) Amendment Act 1999*; *Victoria (Trustee and Trustee Companies (Amendment) Act 1995*).

⁵³ E.g., *Trustee Act 1925* (NSW), s. 14C(1); *Trusts Act 1973* (Qld), s. 24(1).

⁵⁴ Ali & Yano, *supra*, n. 1 at 135-37.

⁵⁵ E.g., *Doneley v. Doneley*, [1998] Qd. R. 602; *Wright v. Wright*, [2002] WASC 30.

- (ii) the composition of the [fund's] investments as a whole including the extent to which the investments are diverse or involve the [fund] in being exposed to risks from inadequate diversification.⁵⁶

This statutory requirement for pension fund trustees to take a whole-of-portfolio approach towards investment selection (MPT) has effectively recast the prudent investor rule.

Fiduciaries also owe beneficiaries a duty of loyalty. It is a long-standing and most fundamental duty, whose underlying purpose is to advance the best interests of the beneficiaries. Traditionally, it has been interpreted as requiring fiduciaries to act exclusively for the beneficiaries as opposed to acting for their own or third-party interests. In the US, the duty of “undivided loyalty”⁵⁷ has been defined as requiring a trustee “to administer the trust solely in the interest of the beneficiary”.⁵⁸ In Canadian law, the duty has been expressed as “to act honestly, in good faith and in the best interests of the members...”.⁵⁹ The “interests of the beneficiaries” to whom the trustee must be loyal are the beneficial interests as provided in the terms of the trust. Courts and legislatures have developed prophylactic rules to ensure fiduciaries act loyally, such as requirements to avoid conflict of interests, not to delegate responsibilities (the “personal performance rule”) and to act impartially towards the beneficiaries (the “even hand” rule).⁶⁰ In recent years the law appears to have evolved in some jurisdictions to allow fiduciaries to consider collateral interests of beneficiaries, such as their status as employees, or third parties to be considered, but they must be subordinate to beneficiaries’ interests.

The duty of loyalty has been interpreted as requiring the trustees to demonstrate that the decision is motivated only by the financial interests of the beneficiary. This particularly applies where the purpose of the trust is to provide financial benefits to beneficiaries, such as a pension plan providing future retirement income. Thus, even if a trustee very carefully undertook an investment strategy, meeting the prudent investor

⁵⁶ Section 52(2)(f)(ii).

⁵⁷ *Meinhard v. Salmon*, 164 N.E. 545, 62 A.L.R. 1, 249 N.Y. 458 (U.S. N.Y. Ct. App., 1928).

⁵⁸ American Law Institute, *supra*, n. 38, s. 5.

⁵⁹ *Pension Benefits Standards Act* (BC), s. 8(5)(b).

⁶⁰ A.B. Laby, “Resolving Conflicts of Duty in Fiduciary Relationships” (2004) 54 Am. U.L. Rev. 75, 99-108.

standard, this would not necessarily discharge the duty of loyalty if it were of no benefit to beneficiaries. However, a “benefit” is not necessarily confined to a financial benefit. If beneficiaries share a moral objection to a particular form of investment, it could be construed as for their benefit if the trust avoided that investment, possibly even at the cost of a lower financial return.⁶¹ A charitable trust is an example where beneficiaries’ interests might be defined in moral rather than strictly financial terms.

In all jurisdictions, fiduciaries may be liable for investments that breach duties of loyalty and prudence. “Imprudence” can range from grossly negligent investment choices, to simple failure to exercise the care and skill of a prudent person.⁶² Criminal sanctions can apply for more serious and flagrant breaches of fiduciary duty. If an investment was improperly divested by some breach of that duty, the trustee could be liable for damages. It is calculated based on the loss of value of the stock or asset, plus the value of the income that would have accrued if the investment had been retained (offset by the investments and earnings of the replacement assets).

Conversely, where the breach is the fiduciary’s failure to select appropriate investments, perhaps due to improper ethical screening, it is possible to demonstrate that had an investment been made, the trust’s investment portfolio would have earned more. Financial returns can be tracked historically, so it is very easy to show that if a different investment was selected, the fund would have performed differently. However, it would be harder to show that the investments were imprudent, as the fiduciary would have had to have the requisite knowledge to anticipate some potential future negative impact on performance – this would be difficult, as one is effectively evaluating the fiduciary on her ability to foretell the future.⁶³ The problem of acknowledging and measuring damages for a breach of an SRI-policy that produced only moral harm to beneficiaries, without financial loss, is noted in the next section.

⁶¹ P. Palmer, *et al.*, *Socially Responsible Investment: A Guide for Pension Schemes and Charities* (London: Haven Publications, 2005) 97.

⁶² Hudson, *supra*, n. 17 at 93-96.

⁶³ On the problems of proving loss and causation generally, see G. Watt & M. Stauch, “Is there Liability for Imprudent Trustee Investment?” (1998) 62 *Conveyancer* 352.

In conclusion, the fiduciary investor rules have been demonstrated to be broadly applicable, flexible and resilient. This flexibility enables accommodation of the wide variety of objectives and circumstances of different investment plan fiduciaries and to adapt over time to changes in the operation of financial markets. Whether this extends to accommodating SRI is examined next.

3. IMPLICATIONS OF FIDUCIARY INVESTOR STANDARDS FOR SRI

(a) Accommodating Non-Financial Benefits

While some commentators observe that the duties of prudential investment and loyalty constrain the scope for SRI,⁶⁴ their contemporary formulation in North America and other jurisdictions may accommodate various SRI policies. Before looking specifically at the pensions sector, some general conclusions can be drawn from the preceding discussion about the implications of fiduciary standards for trustees wishing to invest ethically. The following arguments suggest that it is far from the case that fiduciary responsibilities forbid or implicitly hinder SRI. Rather, both the fiduciary responsibilities of investors and the definition and methods of SRI are sufficiently flexible to allow SRI in some situations. Fiduciary responsibilities may not generally allow financial returns to be sacrificed, but there remains plenty of scope for SRI within the fiduciary framework.

The first major observation is that fiduciaries have an overarching responsibility to promote the best interests of their beneficiaries, and in the context of modern financial markets this has usually meant to optimize financial returns. Because financial returns is an easy yardstick to measure, optimization of financial returns is perhaps a construct of the courts as much as financial markets. Some courts or legislatures have framed the duty as one of not merely acting in their “best” interests but in their “sole interests”.⁶⁵ A sole interest test makes it irrelevant to consider whether the investments provide collateral benefits to others (*e.g.*, a local community or the natural environment). However, the law

⁶⁴ Hutchinson & Cole, *supra*, n. 1, Langbein & Posner, *supra*, n. 1; Ali & Yano, *supra*, n. 1 at 128-39.

⁶⁵ *E.g.*, Australia’s *Superannuation Industry (Supervision) Act 1993*, s. 62.

is evolving to sometimes favour a “best interest” test, which may therefore accommodate collateral benefits so long as no conflict of interest arises. In a pension plan context, the European Union’s Occupational Pensions Directive provides in its investment rules that “the assets shall be invested in the best interests of the members and beneficiaries”.⁶⁶ The US Department of Labor, which administers the ERISA, has advised that the statute’s fiduciary standards “do not preclude consideration of collateral benefits, such as those offered by a ‘socially-responsible’ fund...”⁶⁷

Whether acting loyally in the best or sole interests of beneficiaries allows fiduciaries to accommodate third party benefits, depends also on how we define the “interests” of beneficiaries. If a trust is established for financial benefits, the interests of beneficiaries will normally be financial. But “benefit” need not be cast purely in financial terms. If the trust is established to further some ethical, social, or charitable goal connected with broader society, then fiduciaries should act in accordance with those benefits.

A second related observation in the case of a trust established to provide financial benefits, is that courts should not find a fiduciary acting imprudently if she considers non-financial objectives without sacrificing financial returns.⁶⁸ However, non-financial goals would have to remain a subordinate investment objective. Given evidence that SRI funds match or even exceed the financial returns of non-SRI funds in the same class,⁶⁹ socially and environmentally responsible companies arguably

⁶⁶ *Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision*, O.J. L. 235/10, Article 18. Also, the UK’s *Occupational Pension Schemes (Investment) Regulations 2005* characterize the trustee’s chief duty to beneficiaries as acting in their “best interests”, except “in the case of a potential conflict of interest, [where they must act] in the sole interest of members and beneficiaries”: clause 4(2).

⁶⁷ Cited in B. Goodman, *The Environmental Fiduciary: The Case for Incorporating Environmental Factors into Investment Management Policies* (Oakland: The Rose Foundation, 2004) 33; among case law on a “best interest” approach, see *Withers v. Teachers’ Retirement System*, 447 F. Supp. 1248 (S.D.N.Y., 1978); affirmed mem. 595 F.2d 1210 (2d Cir., 1979); *Board of Trustees v. Baltimore (Mayor)*, 317 Md. 72, 562 A.2d 720 (1989); *Donovan v. Bierwith*, 680 F.2d 263 (2d Cir., 1982).

⁶⁸ *E.g., Bishop of Oxford v. Church Commissioners for England*, [1992] 1 W.L.R. 1241 (U.K.).

⁶⁹ See, *e.g.*, M.V. Russo & P.A. Fouts, “A Resource-Based Perspective on Corporate

constitute a prudent investment choice, when clearly evaluated against financial criteria alone.⁷⁰ Often, social and environmental risks are material to financial returns, and companies with positive environmental performance also enjoy sound financial performance.⁷¹

But while improved corporate environmental performance may correlate positively with financial performance, sometimes the relationship does not correlate.⁷² Where governmental or social sanctions against environmental harm are absent or feeble, economic development at the expense of the environment can boost corporate profits. In such circumstances, financial markets reward companies that exploit these weaknesses rather than those firms that refrain from doing so. Because businesses can benefit from exploiting systemic weaknesses where governmental or social sanctions are lacking, capital markets perversely amplify the incentives for companies to take full advantage. Conversely, companies that refrain from exploitation suffer competitive disadvantages.

Yet, a third key consideration is that fiduciary investors who utterly ignore environmental and social considerations arguably may also con-

Environmental Performance and Profitability" (1997) 40(3) *Academy of Management Journal* 534; C.A. Mallin, B. Saadouni & R.J. Briston, "The Financial Performance of Ethical Investment Funds" (June 1995) *Journal of Business Finance and Accounting* 22; S. Foerster & P. Asmundson, "Socially Responsible Investing: Better for Your Soul or Your Bottom Line?" (2001) 14(4) *Canadian Investment Review* 26.

⁷⁰ See S. Labatt & R.R. White, *Environmental Finance: A Guide to Environmental Risk Assessment and Financial Products* (New Jersey: John Wiley and Sons, 2002) at 151-55.

⁷¹ E.g., L. Mahoney & R. Roberts, "Corporate Social and Environmental Performance and Their Relation to Financial Performance and Institutional Ownership: Empirical Evidence on Canadian Firms" (Toronto: on file at Jantzi Research, 2002); S.A. Waddock & S.M. Graves, "The Corporate Social Performance Financial Performance Link" (1997) 18(4) *Strategic Management Journal* 303; D. Edwards, *The Link Between Environmental and Financial Performance* (London: Earthscan, 1998). Financial markets can punish polluters by reducing prices for their company shares: D. Cormier, M. Magnan & B. Morard, "The Impact of Corporate Pollution on Market Valuation: Some Empirical Evidence" (1993) 8(2) *Ecological Economics* 135; P. Lanoie, P. Laplante & M. Roy, "Can Capital Markets Create Incentives for Pollution Control?" (1998) 26 *Ecological Economics* 31.

⁷² See further C. Mackenzie, "The Scope for Investor Action on Corporate Social and Environmental Impacts", in R. Sullivan & C. MacKenzie (eds.), *Responsible Investment* (Sheffield: Greenleaf Publishing 2005) 20.

travene their fiduciary obligations. Some ecological and human rights issues are becoming so pervasive and serious that few investors can continue to be indifferent to their impact. Climate change is an example. Recently, some investment advisors and consultants suggest that pension trustees have a fiduciary duty to specifically consider the financial risks of climate change.⁷³

Institutional investors are waking up to the threat of global warming.⁷⁴ In 2000, the Carbon Disclosure Project was established to provide an international secretariat for the world's major institutional investors to collaborate on the business implications of climate change.⁷⁵ In 2003, an Investor Network on Climate Risk (INCR) was formed to promote better understanding of the financial risks and investment opportunities posed by climate change.⁷⁶ The INCR presently includes some 50 institutional investors collectively managing US\$3 trillion in assets. Over 400 institutional investors attended the INCR's Summit on Climate Risk held in May 2005 at the UN headquarters in New York.⁷⁷ They see climate change as a defining factor for industries that produce significant carbon dioxide emissions, such as in the energy, automobile and forestry sectors. In the UK, the Institutional Investors Group on Climate Change provides a forum for collaboration at a national level among pension funds and other institutional investors on climate change risks and investment opportunities.⁷⁸

The breadth of institutional investors' assets across the economy also reinforces the fiduciary-like responsibilities to respect the wider social and environmental ramifications of their investments.⁷⁹ It would

⁷³ "Climate Change a 'Fiduciary Duty' for Trustees – Mercer" *Environmental Finance* (Sept. 2005); Mercer Investment Consulting, *A Climate for Change – A Trustee's Guide to Understanding and Addressing Climate Risk* (Toronto: Mercer Investment Consulting, 2005).

⁷⁴ See A. Dlugolecki, *Climate Change and the Financial Services Industry* (Geneva: UNEP Finance Initiatives Climate Change Working Group, 2002).

⁷⁵ Online: Carbon Disclosure Project <www.cdproject.net>.

⁷⁶ Online: Investor Network on Climate Risk <www.incr.com>.

⁷⁷ A.A. Dossal & M.S. Lubber, "Climate Change: Investment Summit Assesses Risks and Opportunities", online: UN Chronicle Online <www.un.org/Pubs/chronicle/2005/issue2/0205p75.html>.

⁷⁸ Online: Institutional Investors Group on Climate Change <www.iigcc.org>.

⁷⁹ See J.P. Hawley & A.T. Williams, *The Rise of Fiduciary Capitalism: How Institutional Investors Can Make Corporate America More Democratic* (Philadelphia:

seem a zero-sum game for an investor to favour a profitable but polluting fossil fuel business if it created risks and costs for other economic sectors the investor has a stake in.

However, these arguments that some acute ecological or social problems engender a special responsibility on fiduciaries do so precisely because of the presence or perceived future likelihood of government regulation, consumer pressure or other social sanctions that would potentially impact the financial performance of their investments. In other words, the responsibilities of fiduciary investors tend to follow rather than lead broader societal responses to social and environmental problems, in so far as it affects performance.⁸⁰ Thus, if climate change were merely an obscure concern of a handful of prescient scientists – which is clearly not the case – arguments that investors have a fiduciary responsibility to take climate change threats into account would seem implausible if there is no effect on financial performance.

Another pragmatic problem with the above arguments is how the courts would measure damages when a fiduciary fails to invest ethically when required to do so by its investment mandate (*e.g.*, a charitable trust). Would this be even more difficult if this omission did not cause financial damage to the beneficiaries? In light of the financial gain, could the latter bring a claim of a breach of fiduciary duty against the trustees for failing to implement an SRI policy? Perez suggests that one possible legal response, as developed by the Israeli Supreme Court, would be the creation of a new tortious remedy. It would focus not on the question of financial damage, “but on the grievance to the individual’s integrity or autonomy, manifested in the deliberate disregard of his moral beliefs and preferences”.⁸¹

University of Pennsylvania Press, 2000); R.A.G. Monks, *The New Global Investors: How Shareowners Can Unlock Sustainable Prosperity Worldwide* (Oxford: Capstone, 2001).

⁸⁰ Financiers only tend to “lead” when there is a clear financial benefit.

⁸¹ O. Perez, “The New Universe of Green Finance: From Self-Regulation to Multi-Polar Governance” in O. Dilling, M. Herberg & G. Winter (eds.), *Responsible Business: Self-Governance in Transnational Economic* (Oxford: Hart Publishing) [forthcoming in 2007], citing *Daaka v. Carmel Hospital - Haifa*, Supreme Court Case 2781/93 and *Tnuva v. Ravi Tufic*, Supreme Court Case 1338/97.

(b) Fiduciary Obligations in the Context of SRI Policies

Specific methods and practices of SRI may also influence how social and environmental considerations interact with broad parameters of fiduciary duties owed to beneficiaries.

To maximize returns or at least to match the performance of the market as a whole, fund managers usually construct diversified investment portfolios based on the precepts of MPT.⁸² But, while contemporary investment standards of diversification no longer require narrow evaluation of investments on a case-by-case basis, they may still hinder some forms of SRI. For example, environmental and social investment screens that constrict investment portfolios by excluding specific companies or economic sectors hamper true diversification.⁸³ Also, diverse portfolios can lead to smaller holdings in any particular investment, thereby reducing trustees' influence in individual companies. This potentially diminishes the scope for the shareholder activist methods of SRI.⁸⁴

Many commentators however stress that fiduciaries have a duty to monitor their investments and actively protect those investments through proxy voting, engaging in dialogue, and other strategies.⁸⁵ While commentators dispute some of the assumptions of MPT⁸⁶ – for example, because markets operate under imperfect information and institutional investors are too large to have a neutral impact on financial markets – MPT retains its prestige among financial regulators and fund managers.⁸⁷

⁸² See further W.F. Sharpe, *Portfolio Theory and Capital Markets* (New York: McGraw-Hill, 1970) at 20-24; R.A. Brealey & S.C. Myers, *Principles of Corporate Finance* (New York: McGraw-Hill, 1988) at 136-39.

⁸³ See P. Luxton, "Ethical Investment by Charities: A Slippery Slope?" (1992) 142 *New L.J.* 16; R. Ellison, "The Golden Fleece? Ethical Investment and Fiduciary Law" (1991) 5(4) *Trust L. Int'l* 157.

⁸⁴ See J.E. Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (Oxford: Clarendon Press, 1995) at 168-69.

⁸⁵ Goodman, *supra*, n. 67 at 32; E. Tasch & S. Viederman, "New Concepts of Fiduciary Responsibility" in F. Capra & G. Pauli (eds.), *Steering Business Toward Sustainability* (Tokyo: United Nations University Press, 1995) 125; R.H. Koppes & M.L. Reilly, "An Ounce of Prevention: Meeting the Fiduciary Duty to Monitor an Index Fund through Relationship Investing" (1995) 20 *J. Corp. L.* 413.

⁸⁶ On the inefficiency of capital markets, see W.F.M. De Bondt & R.H. Thaler, "Further Evidence on Investor Overreaction and Stock Market Sensationality" (1987) 42(3) *Journal of Finance* 557; B.N. Lehmann, "Fads, Martingales and Market Efficiency" (1990) 105(1) *Quarterly Journal of Economics* 1.

⁸⁷ See W. Lee, "Modern Portfolio Theory and the Investment of Pension Funds" in P.

Finally, in some situations the duty to diversify can actually favour environmentally sound investment choices; for example, in the energy sector, this should entail moving beyond just fossil fuel industry investments to include renewable energy companies supplying wind and solar power.

A second aspect of SRI policies is that where fiduciaries seek to take social, ethical and environmental considerations into account to provide non-financial benefits, they should consult with the beneficiaries. A common argument against SRI policies based on members' preferences is that beneficiaries may hold conflicting views on ethical questions. While disagreements will most likely permeate traditional ethical or religious issues, such as alcohol or gambling, substantial agreement in other areas may readily arise. For instance, members of a pension fund probably rarely favour deliberate environmental degradation or human rights' violations. In the pension sector, the development of SRI options rather than a single investment policy across a common fund can help to accommodate diverse preferences among members.⁸⁸

Where fiduciaries factor ethical preferences into their investment policy, they should ensure that these are their beneficiaries and not their own.⁸⁹ Thus, fiduciaries should ascertain the views of beneficiaries, and keep them informed about implementation of an SRI policy. The advancement of social or ethical values is a non-financial benefit. A further pragmatic reason to consult with beneficiaries is that they probably cannot, if properly informed, hold the trustee liable for a breach of trust if the beneficiaries consented to it.⁹⁰ Consent is directly responsive to the policy that informs the loyalty rule, which is to maximize the best interests of the beneficiary.

A third aspect of the methods of SRI is that while inflexible negative screens may collide with fiduciary duties because of their exclusion of certain sectors, this is not so with other SRI strategies. Best of sector methods allow for retention of a diverse portfolio in accordance with

Finn (ed.), *Equity and Commercial Relationships* (Sydney: Law Book Company, 1987) 303; M.E. Porter, "Capital Disadvantage: America's Capital Investment System" (1992) 70(5) *Harvard Business Review* 65.

⁸⁸ Palmer, *et al.*, *supra*, n. 61 at 110.

⁸⁹ See *Clore's Settlement Trusts, Re*, [1966] 2 All E.R. 272 (U.K.) at 275.

⁹⁰ See, *e.g.*, US Uniform Trust Code, s. 802(b)(4), 7C U.L.A. 229 (Supp.).

MPT. Further, corporate engagement, where investors seek to influence company management rather than passively invest, should contribute to the fulfilment of fiduciary responsibilities. Indeed, investment managers who do not act when faced with evidence of poor corporate governance may breach fiduciary standards.⁹¹ The UK's Myners Report on institutional investment considered that where shareholder activism was in the best financial interests of the beneficiaries, it was "arguably already a legal duty of both pension fund trustees and their fund managers to pursue such strategies".⁹²

Further, SRI policies typically garner additional research that in turn can provide a better understanding of individual companies. This may ultimately contribute to better stock selection. Conversely, the additional administrative costs involved in implementing SRI methods can create additional fund management expenses, which can in turn diminish returns to fund beneficiaries.⁹³ So, the costs of SRI strategies including corporate engagement must be balanced against the potential increased returns from added vigilance.

A second more fundamental objection to active monitoring and engagement management is that it conflicts with the "efficient market" theory.⁹⁴ This theory's core premise is that capital markets are efficient because "the prices of goods sold in that market fully reflect all available information about those goods".⁹⁵ It therefore posits that one cannot "beat the market" because in order to do so the investor would need information about businesses that is not yet generally known. But sometimes there is a delay between a company's financially relevant environmental record and the reaction of the "efficient market" to that information.⁹⁶ Thus, fiduciaries who entrust the market to efficiently

⁹¹ R.H. Koppes & M.L. Reilly, "An Ounce of Prevention: Meeting the Fiduciary Duty to Monitor an Index Fund Through Relationship Investing" (1995) 20 Iowa J. Corp. L. 414.

⁹² P. Myners, *Institutional Investment in the United Kingdom: A Review* (London: HM Treasury, 2001), chapter 5, at 115, para. 5.

⁹³ P.U. Ali & M. Gold, "Investing for Good: The Cost of Ethical Investment" (2002) 20(5) Company and Securities Law Journal 307.

⁹⁴ The theory was pioneered in E. Fama, "Capital Markets: A Review of Theory and Empirical Work" (1970) 25(2) Journal of Finance 383.

⁹⁵ J.R. Macey, "An Introduction to Modern Financial Theory" 36 (1991) *Begleiter* 37.

⁹⁶ For general criticisms of the theory, see B.G. Malkiel, "The Efficient Market Hypothesis and Its Critics" (2002) 17(1) Journal of Economic Perspectives 59; R. Ball,

capture environmental behaviour may fail to act in their beneficiaries' best interests. Some empirical research shows that investors who engage in corporate governance (*e.g.*, filing shareholder resolutions and asking questions to company management) outperform their peers on measures such as return on investments.⁹⁷

A final seminal observation about implications of fiduciary duties for SRI is that the applicable trust instrument governs a trustee's duties and investment decisions foremost.⁹⁸ This is another aspect of the duty of loyalty. Thus, if that trust deed expressly requires the trustee to invest according to specific (*e.g.*, ethical) criteria, then it must heed those criteria.⁹⁹ For instance, charitable trusts and mission-based institutions are typically organized under a trust mandate that expressly directs how the eleemosynary institution will invest for philanthropic purposes. The UK Charity Commission, which supervises British charities under the *Charities Act 1993*, has issued guidance stressing that charities can make investments that do not seek the best financial returns, if they advance the organization's charitable goals.¹⁰⁰

For a new investment scheme, the trust deed may be drawn up on any terms, subject to statutory and commercial restrictions. For example, taxation legislation may only provide tax concessions to trusts established for the sole purpose of providing financial benefits to members.¹⁰¹ Therefore, it may be more difficult to amend an existing trust, as this power must normally be exercised only for a granted purpose. Amend-

"The Theory of Stock Market Efficiency: Accomplishments and Limitations" (Spring, 1995) *Journal of Applied Corporate Finance* 4.

⁹⁷ See, *e.g.*, G. Morgenson, "Shares of Corporate Nice Guys Can Finish First" (27 April 2003) *New York Times*, section 3 at 1.

⁹⁸ See *McCreight v. 146919 Canada Ltd* (1991), 1991 CarswellOnt 527, 35 C.C.E.L. 282, 40 E.T.R. 184, [1991] O.J. No. 136 (Ont. Gen. Div.); affirmed (1993), 1993 CarswellOnt 938, 46 C.C.E.L. 271, C.E.B. & P.G.R. 8150 (Ont. C.A.); leave to appeal refused (1994), 7 C.C.E.L. (2d) 44 (note), 75 O.A.C. 160 (note), 176 N.R. 318 (note) (S.C.C.).

⁹⁹ Although, discriminatory provisions in a trust may be voided by courts on the basis of being against public policy or statutory human rights provisions: see, *e.g.*, *Canada Trust Co. v. Ontario (Human Rights Commission)* (1990), 74 O.R. (2d) 481, 1990 CarswellOnt 486, 69 D.L.R. (4th) 321, 12 C.H.R.R. D/184, 38 E.T.R. 1, (sub nom. *Leonard Foundation Trust, Re*) 37 O.A.C. 191 (Ont. C.A.).

¹⁰⁰ Charity Commission, "Guidance on Programme-Related Investment", (May 2001) online: <www.charitycommission.gov.uk/supportingcharities/casi.asp>.

¹⁰¹ Palmer, *et al.*, *supra*, n. 61 at 106.

ments that purport to authorize investments not consistent with the objects of the trust may be impeachable.¹⁰²

In conclusion, SRI policies can meld with fiduciary responsibilities. But, they normally cannot sacrifice financial returns unless the governing trust instrument gives primacy to non-financial goals. Yet, as shown in the foregoing discussion, the dichotomy between SRI and fiduciary investment standards may be non-existent. Many methods of SRI such as shareholder activism can actually fulfill fiduciary responsibilities. Further, fiduciaries should pay attention to significant environmental risks that may impact financial performance. However, because of the arbitrary and subjective nature of some SRI compared to the seeming clarity of traditional fund management objectives to optimize financial returns, explicit guidance on SRI in regulation or the governing trust instruments would be helpful.

The next section of this article examines in detail how fiduciary responsibilities and SRI interact in relation to occupational pension funds in common law jurisdictions. We must examine how the specific institutional and legal characteristics of investment intermediaries affect SRI.

4. PENSION FUNDS

(a) Basic Principles

An occupational pension fund is a financial institution established by employers and workers to pay benefits upon the retirement of fund members. By virtue of the huge capital resources they command, pension funds are potentially the most influential financial institution for SRI.¹⁰³

Hawley and Williams contend that because pension funds and other institutional investors are “universal owners”. As they hold a broad portfolio of stocks and other assets, they are inherently biased towards

¹⁰² *Ibid.*

¹⁰³ See I. Carmichael, *Pension Power: Unions, Pension Funds, and Social Investment in Canada* (Toronto: University of Toronto Press, 2005); A. Read, “Building Signposts for the Future: Investment Strategy, Socially Responsible Investing, and ERISA” (1997) 23 *Journal of Pension Planning and Compliance* 39; A. Neale, “Pension Funds and Socially Responsible Investment” (2001) 1(2) *Journal of Corporate Citizenship* 43.

the health and long-term sustainability of the entire economy rather than just the profitability of individual firms.¹⁰⁴ This is further reinforced by the long-term nature of pension funds' financial liabilities. Apart from a good retirement income, pension fund members also desire a clean, safe and secure world. Given the ubiquity of pension fund membership, the interests of members should be broadly consistent with those of the society in which members live.

Similarly, Monks contends that the universal investor (or "global investors" as he calls them) "is likely to make good decisions for the long-term of society, because it can afford in most cases to take a long-term view, and a diversified view. An ordinary domestic investor may need to reap profits in the short term".¹⁰⁵ Gifford adds that given the ubiquity and size of pension fund holdings, they:

generally prefer indexing strategies, in which they invest in almost every stock in the market to match a major market index. Therefore, if one company causes environmental damage, another company will often suffer, and that company will also be in the fund's portfolio so it is a zero sum game for the fund. Similarly, if the environmental cost is externalised onto the taxpayer (i.e. to clean up a toxic waste site), those taxpayers will most likely also be members of the fund.¹⁰⁶

Thus, in theory, pension funds should be particularly attentive to the social and environmental performance of their investee companies, even if it means that a particular company must be divested from the fund's portfolio.

Occupational pension funds in common law jurisdictions are commonly established under a trust arrangement.¹⁰⁷ Typically, the employer, as settlor, vests the pension fund and its earnings in one or more pension trustees on behalf of employee beneficiaries. Trustees have legal title to the fund's assets and consequently have power over the investment and management of those assets. Pension fund and trustee legislation generally do not specify the types of investments that a fiduciary must make. Rather, trustees of pension funds enjoy a plenary power to invest in any

¹⁰⁴ Hawley & Williams, *supra*, n. 79.

¹⁰⁵ Monks, *supra*, n. 79 at 105.

¹⁰⁶ J. Gifford, "Measuring the Social, Environmental and Ethical Performance of Pension Funds" (2004) 53 *Journal of Australian Political Economy* 139 at 140-41.

¹⁰⁷ E.E. Gillese, "Pension Plans and the Law of Trusts" (1996) 75 *Can. Bar Rev.* 221; L. Millett, "Pension Schemes and the Law of Trusts: The Tail Wagging The Dog?" (2000) 14(2) *Trust L. Int'l.*

type of investment subject to restrictions imposed by the governing trust deed, their fiduciary obligations and government regulations.¹⁰⁸

A further seminal consideration is that a pension plan is not merely a trust; it is also a contract. Indeed, where there is no evidence of an intention to establish a trust, contract law and any applicable public regulation govern arrangements.¹⁰⁹ A pension plan is a contract between an employer and its employees, and forms a valuable component of the contract of employment.¹¹⁰ Therefore, pension rights established under contract can arise independently of rights established under other legal mechanisms such as a trust. It is therefore possible that pension plan members could acquire specific rights regarding investment policies of their pension plan by contract.

Scholars are divided on the relationship between contract law and fiduciary investment duties. Maxton and Farrar believe courts should look at the contractual framework when considering whether pension trusts can engage in SRI.¹¹¹ On the other hand, Ali and Yano contend that “investors do not have the right to dictate the design and implementation of the fund’s investment strategy to the fiduciary”.¹¹² This is because, in their opinion, “it is a well established principle of trust law that a fiduciary cannot fetter the exercise of its investment powers and thus enter into an arrangement or adopt an inflexible investment policy that is determinative of the future exercise of its investment powers”.¹¹³ However, original contractual provisions governing workers’ pension rights, such as those contained in a collective bargaining agreement, would be matters that the employer as the settlor would have to incorporate into the terms of the pension trust governing the fiduciary.

¹⁰⁸ A standard trust deed contains details of the rights, powers, and remuneration of the trustee(s), details of benefits of members, winding up provisions, disclosure, record keeping and actuarial review. See, e.g., *Trustee Act 2000* (UK), c. 29 ss. 3(1) and 6(1)(b); *Pensions Act 1995* (UK), c. 26, s. 34(1).

¹⁰⁹ A.N. Kaplan, *Pension Law* (Toronto: Irwin Law, 2006) at 17.

¹¹⁰ *Ibid.*, at 13.

¹¹¹ J.H. Farrar & J.K. Maxton, “Social Investment and Pension Scheme Trusts” (1986) 102 *Law Q. Rev.* 32 (discussing the UK case of *Cowan v. Scargill*, 1984).

¹¹² Ali & Yano, *supra*, n. 1 at 140.

¹¹³ *Ibid.*, citing among authorities, *Gibson’s Settlement Trusts, Re*, [1981] Ch. 179 (U.K.), and *Allen-Meyrick’s Will Trusts, Re*, [1966] 1 W.L.R. 499.

The interests of employees are further enhanced by the growing shift from defined-benefit to defined-contribution pension plans.¹¹⁴ In a defined-benefit plan, retirement benefits are pre-determined by a formula usually based on the employee's length of service multiplied by a certain percentage. In the contrasting defined-contribution pension plan, the employee's contribution rates are fixed by the plan and the retirement benefits paid depend on the performance of the plan. Hybrid pension plans can combine elements of both models.¹¹⁵ Historically, most pension plans offered defined benefits. In the wake of fluctuating stock market returns and greater market uncertainty, which make it difficult to guarantee returns, many companies have sought to convert their pension plans to defined-contribution schemes.¹¹⁶

The choice of a defined-benefit or defined-contribution plan has different financial risk implications. With a defined-benefit plan, the employer or plan sponsor bears the primary risk that employees receive a pre-defined pension income on retirement.¹¹⁷ A defined-contribution plan shifts that risk to the employees. Arguably, therefore, those employees should concomitantly acquire greater rights over the pension plan's choice of investments including SRI options (though whether employees would be more willing to sacrifice returns on their retirement benefits is debatable).¹¹⁸ Where the employer guarantees retirement benefits, it is understandable that the employer may wish to exclude SRI if that option would materially risk lower investment returns.¹¹⁹

Although trustees appointed by the employer or other plan sponsors bear legal responsibility for controlling the assets of the trusts, trustees of pension plans often delegate aspects of investment decision-making

¹¹⁴ On this shift, see A. Byrne, "Investment Decision Making in Defined Contribution Plans" (2004) 10(1) *Pensions: An International Journal* 37.

¹¹⁵ Kaplan, *supra*, n. 109 at 101-02.

¹¹⁶ *Ibid.*, at 4.

¹¹⁷ However, even with a defined-benefit model, employees face some risks; their pension contributions may rise to meet liabilities, and the employer may go bankrupt.

¹¹⁸ R.A.G. Monks & N. Minow, *Power and Accountability* (New York: Harper Collins, 1991) at 223.

¹¹⁹ Interestingly, however, UK research suggests the recent shift to defined contribution schemes may discourage SRI because where members are given investment choices they tend to be more risk-averse and therefore choose bonds rather than equities. There is less scope for SRI in the bond market: Palmer, *et al.*, *supra*, n. 61 at 126.

to professional fund managers.¹²⁰ An investment management agreement typically governs the relationship between trustees and their fund managers.¹²¹ Legislation typically makes fund managers effectively subject to the same prudential investment obligations as trustees.¹²² Moreover, fund managers often have a contractual obligation to provide services or advice that enable trustees to meet their fiduciary duties. Thereby, fund managers must respect fiduciary duties of trustees.¹²³ Fund managers also have a general contractual duty at common law to apply due skill and care.¹²⁴

Pension funds invest in capital markets, particularly stocks, bonds and real estate.¹²⁵ Pension trustees have customarily resisted ethically based investments in the belief that they contravene fiduciary duties prevalent in trust law.¹²⁶ However, as the next section shows, little case law supports this assumption.

The following sections canvass developments in the UK, US and Australia, where there have been the most active litigation and legislative interest in SRI issues. There is no Canadian case law on SRI by pension funds or other investment institutions.

(b) UK Case Law

In Britain, the question of whether fiduciary responsibilities of investment trustees allow them to invest ethically was considered in the

¹²⁰ K.P. Ambachtsteer & D. Ezra, *Pension Fund Excellence: Creating Value for Stockholders* (New Jersey: John Wiley and Sons, 1998) at 67-71.

¹²¹ See generally S. Willey, "Investment Management and Fiduciary Duties" in D. Frase (ed.) *Law and Regulation of Investment Management* (London: Sweet and Maxwell, 2004).

¹²² *E.g.*, UK's *Pensions Act 1995*, s. 36 (duties to assess the suitability of each investment and have regard to the need for diversification).

¹²³ Freshfields Bruckhaus Deringer, *supra*, n. 11 at 85.

¹²⁴ *Ibid.*, at 91.

¹²⁵ See generally G.L. Clark, *Pension Fund Capitalism* (Oxford: Oxford University Press, 2000).

¹²⁶ See A. Emid, "The Ethical Choice: It Takes a Steady Hand to Balance Fiduciary Responsibility with Ethical Goals" (1997) 21(4) *Benefits Canada* 89; Hutchinson & Cole, *supra*, n. 1; D. Hayton, "English Fiduciary Standards and Trust Law" (1999) 32 *Vand. J. Transnat'l L.* 555.

cases of *Cowan v. Scargill*,¹²⁷ *Martin v. Edinburgh (City) District Council*¹²⁸ and *Bishop of Oxford v. England (Church Commissioner)*.¹²⁹

The first of these cases, *Cowan v. Scargill*, attracted considerable attention from SRI commentators.¹³⁰ Trustees appointed jointly by the National Coal Board (NCB) and the National Union of Mine Workers governed the pension plan in question. Union trustees disapproved of the proposed investment plan unless it prohibited any increase in foreign investment, in particular, any investment in energy industries in competition with coal. The NCB trustees commenced legal proceedings against union trustees claiming that they were in breach of fiduciary duties by insisting on the proposed restrictions.

The judge, Vice-Chancellor Robert Megarry, agreed with the NCB trustees. Starting from the proposition that trustees must treat interests of beneficiaries as paramount, he reasoned that the best interests of the beneficiaries were normally their *financial* interests.¹³¹ If the only actual or potential beneficiaries of a trust were individuals with strict views on moral or social matters, Megarry V-C conceded that it would be understandable that it might not be for the “benefit” of such beneficiaries to invest to maximize financial return. Finally, Megarry V-C emphasized the applicable statutory duty to have regard to the need for diversification of investments. Non-financial criteria could be considered in diversification assuming there were equally beneficial alternatives.

Despite the attention given to the *Cowan* case, it is not a significant precedent and has at times been misinterpreted.¹³² Megarry V-C was a sole judge sitting in the Chancery Division of the High Court, the lowest tier of the higher English civil law courts. Also, the question of whether taking social, environmental and ethical considerations into account might improve investment return never arose in the case. What the Megarry V-C judgment does exclude is SRI decisions based on the

¹²⁷ [1985] 1 Ch. 270 (U.K.) [*Cowan*].

¹²⁸ [1988] S.L.T. 329.

¹²⁹ [1992] 1 W.L.R. 1241 (U.K.); [1993] 2 All E.R. 300 (U.K.) [*Bishop of Oxford*].

¹³⁰ E.g., P. Docking & I. Pittaway, “Social Investment by English Pension Funds: Can it Be Done?” (1990) *Trust Law and Practice* 25.

¹³¹ *Cowan*, *supra*, n. 127.

¹³² For criticisms of Megarry’s judgment, see Maxton & Farrar, *supra*, n. 111.

“personal interests and views” of the trustees, which can “not be justified on broad economic grounds”.¹³³

Curiously, Megarry V-C himself reflected on his decision in a 1989 academic article.¹³⁴ He explained that his judgment in *Cowan* did not mean profit maximization alone was consistent with the fiduciary duties of a pension fund trustee. Moreover, he wrote that if the trustees in *Cowan* had framed their investment policy as a preference rather than an absolute prohibition, then it would have been difficult to admonish.

In the next British case, the Bishop of Oxford and some fellow clergy sought a declaration that Church of England Commissioners should not invest in a manner incompatible with the Christian faith when managing their assets, even if there was a risk of significant financial detriment.¹³⁵ The Court found that the Commissioners were in the same position as trustees with respect to the fund in question. And though the Commissioners had an ethical investment policy, it was to apply only to the extent that such considerations did not significantly jeopardize financial returns.

In declining to approve the more activist approach sought by the Bishop of Oxford,¹³⁶ Nicholls V-C accepted that there were at least two exceptions to the duty to maximize financial returns. Namely, where the aims of the charity and objects of investment conflict and, where particular investments detract from the charity’s work, trustees must weigh the extent of financial loss from offended supporters and the financial risk of exclusion.¹³⁷ Thus, in his reasoning, if trustees sought professional advice and were choosing between two investments, which according to conventional principles of prudential investment were equally suitable, then ethical considerations could be the deciding factor (“the tie-

¹³³ *Cowan, supra*, n. 127 at 296.

¹³⁴ R. Megarry, “Investing Pension Funds: The Mineworkers Case” in TG Youdan (ed.), *Equity, Fiduciaries and Trusts* (Toronto: Carswell, 1989) 149.

¹³⁵ *Bishop of Oxford, supra*, n. 129.

¹³⁶ The Church Commissioners’ investment policy already excluded investment in 13% (by value) of publicly listed UK companies, while the Bishop of Oxford proposed further ethical exclusions which would have increased the level of exclusion to 37% of the total market: G. Watt, *Trusts and Equity*, 2nd ed. (Oxford: Oxford University Press 2006) at 436.

¹³⁷ *Bishop of Oxford v. England (Church Commissioners)*, [1993] 2 All E.R. 300 (U.K.) at 304.

breaker principle”). However, whether such principles apply to all investment trusts such as pension plans is unclear. Nicholls V-C cautioned that this case involved charities whose “purposes are multifarious”, unlike other “trusts for the provision of financial benefits for individuals”.¹³⁸

In the Scottish case of *Martin v. Edinburgh (City) District Council*, the majority of the Edinburgh District Council trustees decided to divest from South Africa because of apartheid.¹³⁹ In a successful challenge to this policy, the court concluded that the trustees of the municipality’s fund breached the trust by implementing a policy of divestment without considering whether it was in the best interests of the beneficiaries and without obtaining professional advice. However, the court did not consider whether such an investment policy was contrary to trust principles *per se*; rather, it addressed only whether the failure to consider the issue constituted a breach of the trustee’s duties. But, significantly, Lord Murray commented:

I cannot conceive that trustees have an unqualified duty simply to invest trust funds in the most profitable investment available. To accept that without qualification would, in my view, involve substituting the discretion of financial advisers for the discretion of trustees.¹⁴⁰

In a further circumvention of the *Cowan* ruling, Lord Murray also rejected the notion that trustees must rid themselves of all personal preferences; rather, “What he must do ... is to recognise that he has those preferences, commitments or principles but nonetheless do his best to exercise fair and impartial judgment on the merits of the issue before him”.¹⁴¹

Since these cases, the *Trustee Act 2000* has amended the powers and duties of trustees. Previously, the *Trustee Investments Act 1961*, now repealed, restricted trustees to certain types of supposed “safe” assets, such as gilt-edged securities and bank accounts. The *Trustee Act 2000* – which governs trusts generally rather than pension plans specifically – makes no express reference to SRI. The legislation does, however, require trustees to consider the “suitability” of investments when

¹³⁸ *Ibid.*

¹³⁹ [1988] S.L.T. 329.

¹⁴⁰ *Ibid.*, at 334.

¹⁴¹ *Ibid.*

exercising their investment powers,¹⁴² and the Charity Commission's initial guidance on the Act's key provisions explained that suitability "will . . . include any relevant ethical considerations as to the kind of investments which it is appropriate for the trust to make".¹⁴³

More relevant to the pension sector, the *Pensions Act 1995*¹⁴⁴ and its subordinate regulations¹⁴⁵ insist trustees' powers of investment "be exercised in a manner calculated to ensure the security, quality, liquidity and profitability of the portfolio as a whole".¹⁴⁶ Also, the assets must be invested "in the best interests of members and beneficiaries",¹⁴⁷ and "must be properly diversified".¹⁴⁸ Further, the trustees must: obtain proper advice when preparing their statement of investment principles,¹⁴⁹ and act in accordance with those principles as far as practicable.¹⁵⁰

Notably, recent *Pensions Act* amendments (2004) do not address the culture of passive investing and lack of corporate engagement of British pension funds, which was one of the findings of the 2001 Myners review of institutional investment in the UK.¹⁵¹ The UK Department of Work and Pensions subsequently proposed a legal duty that pension fund administrators "must, in respect of any company or undertaking . . . in which they invest such assets, use such rights and powers as arise by virtue of such investment in the best interests of the members and beneficiaries of such scheme".¹⁵² This proposal would have generated greater shareholder activism beneficial to SRI but was not legislated into practice. Instead, the matter was left for voluntary action pursuant to the Myners Code of Investment Principles.¹⁵³

¹⁴² Section 4.

¹⁴³ Online: Charity Commission <www.charity-commission.gov.uk/supportingcharities/default.asp>.

¹⁴⁴ See sections 33-36.

¹⁴⁵ *Occupational Pension Schemes (Investment) Regulations, Statutory Instrument 2005 No. 3378*, cl. 4(3).

¹⁴⁶ *Ibid.*, cl. 4.

¹⁴⁷ *Ibid.*, cl. 4(2)(a).

¹⁴⁸ *Ibid.*, cl. 4(7).

¹⁴⁹ *Ibid.*, cl. 2(2)(a).

¹⁵⁰ *Pensions Act 1995*, c. 26, s. 36(5).

¹⁵¹ Myners, *supra*, n. 92.

¹⁵² Department of Work and Pensions (DWP), *Encouraging Shareholder Activism: A Consultation Document* (London: DWP, 2002) 8.

¹⁵³ HM Treasury, *Myners Principles for Institutional Investment Decision-Making: Review of Progress* (London: HM Treasury, 2004).

On the other hand, UK legislators pioneered a potentially crucial innovation: in 2000, regulations under the *Pensions Act* came into effect requiring trustees of all occupational pension plans to disclose whether the plan has an ethical investment policy. The details and impact of that reform are discussed in the final section of this article.

Finally, it must be noted that UK pensions and financial regulation is also increasingly shaped by European Union regulation, such as the Occupational Pensions Fund Directive.¹⁵⁴ This Directive *inter alia* imposes modern prudent investment standards already familiar to UK domestic law.¹⁵⁵

(c) US Pension Funds

Pensions legislation and case law in the US contains similar investment rules and standards to that found in the UK. The federal *Employee Retirement Income Security Act 1974* (ERISA) outlines general standards of fiduciary conduct for private occupational pension plans.¹⁵⁶ Principally, it requires that plan trustees and their investment managers exercise their responsibilities:

1. “Solely in the interest of plan participants and beneficiaries”;
2. “For the exclusive purpose of providing benefits” and “defraying reasonable expenses of administering the plan”;
3. “With the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character with like aims”;
4. “By diversifying investments . . . so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so”; and
5. In accordance with plan documents.¹⁵⁷

¹⁵⁴ *Supra*, n. 66.

¹⁵⁵ *Ibid.*, Article 18 (the Directive is most relevant to the civil law EU jurisdictions which have historically favoured quantitative investment rules rather than prudent investment standards).

¹⁵⁶ ERISA, s. 404.

¹⁵⁷ *Ibid.*

The ERISA does not explicitly refer to the possibility of SRI, and so the matter has been left to the courts and the guidance issued by the US Department of Labor. The Department has issued various non-binding Interpretative Bulletins that touch on SRI.¹⁵⁸ For instance, it has advised that shareholder activism is:

consistent with a fiduciary's obligations under ERISA where the responsible fiduciary concludes that there is a reasonable expectation that such monitoring or communication with management, by the plan alone or together with other shareholders, is likely to enhance the value of the plan's investment in the corporation, after taking into account the costs involved.¹⁵⁹

For federal government pension plans, a bill for a *Federal Employees Responsible Investment Act* was introduced in the US House of Representatives in 2004.¹⁶⁰ If passed, the law would compel government pension plans to offer an SRI index fund option in the Thrift Savings Plan for all federal employees.¹⁶¹

The most significant US case on SRI was the *Board of Trustees of Employee Retirement System of Baltimore (City) v. Baltimore (City)*.¹⁶² This case dealt with a public sector pension plan, though governed by common law fiduciary duties considered similar to ERISA standards. Here the Maryland Court of Appeal examined the City's ordinances requiring its four municipal pension funds to divest from companies engaged in business in South Africa. The trustees argued that the ordinance altered their common law duties of prudence by substantially reducing the universe of eligible investments.

While the court in *Baltimore (City)* agreed that the ordinances excluded a "not insignificant segment of the investment universe",¹⁶³ it accepted evidence that the lowering of the rate of return expected from

¹⁵⁸ US Department of Labor, Interpretative Bulletin (Interpretative bulletin relating to statements of investment policy, including proxy voting policy or guidelines), *Code of Federal Regulations*, 29 Ch XXV, 2509. 94-2 (1994).

¹⁵⁹ *Ibid.*

¹⁶⁰ H.R. 4140, online: <http://thomas.loc.gov/cgi-bin/query/z?c108:_H.R.4140.IH:>. In May 2005 the bill was Referred to the House Committee on Government Reform.

¹⁶¹ The TSP is a retirement savings plan for civilians employed by the US federal government and members of the armed services. The Federal Retirement Thrift Investment Board administers the TSP in accordance with the *Federal Employees' Retirement System Act 1986*.

¹⁶² 317 Md. 72, 562 A.2d 720 (1989).

¹⁶³ *Ibid.*, at 103.

the divestiture in South Africa would only amount to about ten basis points per year,¹⁶⁴ and the measured way the divestments were to occur meant that the divestiture program did not alter the trustees' prudential duties. The court explained: "Thus, if ... social investment yields economically competitive returns at a comparable level of risk, the investment should not be deemed imprudent".¹⁶⁵

Trustees also argued that the ordinances altered the common law duty of loyalty, because no longer would investment occur exclusively for providing benefits to members. Again, the court found this provision did not cause trustees to violate their investment duties so long as the cost of investing according to social responsibility precepts was *de minimis*, as was considered here. The court explained that a trustee's duty is not to maximize return on investments, but only to secure a "just" and "reasonable" return, while avoiding undue risk.¹⁶⁶

Interestingly, the Maryland Court of Appeal also expressly recognized the relevance and influence of public opinion in the selection of investments:

The Mayor and City Council of Baltimore were motivated to enact the Ordinances in part, because the Trustees' prior investment practices offended a growing number of the systems' beneficiaries and residents of the City. Moreover, given the vast power that pension trust funds exert in American society, it would be unwise to bar trustees from considering the social consequences of investment decisions in any case in which it would cost even a penny more to do so.¹⁶⁷

Although not strictly an SRI case, the decision in *Withers v. Teachers' Retirement System*¹⁶⁸ also suggests the US courts' willingness to condone pension trustees who take collateral issues into account when determining the long-term, best interests of plan beneficiaries. There, trustees of a teachers' pension fund invested US\$860 million in bonds issued by the City of New York, under which there was no guarantee of a return as the bond issue was an attempt to prevent the looming bankruptcy of the City. The City was also the major employer of the teachers and, as a substantial contributor to their fund, was the ultimate guarantor

¹⁶⁴ Basis points are the smallest measure used to calculate interest rates or yields on investments. For example, ten basis points equal 0.1 percent.

¹⁶⁵ *Ibid.*, at 107.

¹⁶⁶ *Ibid.*

¹⁶⁷ *Ibid.*, at 108.

¹⁶⁸ 447 F. Supp. 148 (SDNT, 1978).

of the liabilities of the fund. After much research, the trustees were satisfied that the City could not obtain financing from other sources. The court held in those circumstances that the seemingly speculative investment made by the trustees was acceptable because of the strong connection between the fund and the City.

Though some critics distinguish the *Withers* case based on its exceptional facts,¹⁶⁹ where the pension plan's survival was dependent on the solvency of the municipality invested in, the recent spate of corporate insolvencies and underfunded pension plans suggests that the *Withers* situation is not unique. The latitude conceded to trustees in *Withers* was also influenced by the absence of any conflicts of interest. In contrast, conflicts of interest were determinative in *Blankenship v. Boyle*.¹⁷⁰ Here, the union pension plan trustees were condemned for holding assets in a union-owned bank for the benefit of the bank.

(d) Australian Superannuation Funds

Australian occupational pension plans (known locally as “superannuation funds”) are governed primarily by the *Superannuation Industry (Supervision) Act 1993* (SIS Act). Concomitant common law duties may apply to superannuation funds. Applicable policy guidance mainly comprises the Australian Securities and Investments Commission's (ASIC) Policy Statements.¹⁷¹ Australian courts have not yet considered the legality of SRI by superannuation funds or SRI in other investment contexts. Legal commentators suggest that English cases provide the best guidance on how Australian courts would deal with the issues.¹⁷²

It is unclear to what extent Australian superannuation legislation allows SRI. Section 62 of SIS Act – the most important provision in this respect – is entitled by the statute as the “Sole Purpose Test”. It provides, in part, that:

- (1) Each trustee of a regulated superannuation fund must ensure that the fund is maintained solely:

¹⁶⁹ Hutchinson & Cole, *supra*, n. 1 at 1363; Langbein & Posner, *supra*, n. 1.

¹⁷⁰ 329 F. Supp. 1089 (1979) at 1112.

¹⁷¹ See online: ASIC <www.asic.gov.au>.

¹⁷² Ali & Kano *supra*, n. 1; A. Leigh, “‘Caveat Investor’: The Ethical Investment of Superannuation in Australia” (1997) 25 Austl. Bus. L. Rev. 341; G.E. Dal-Pont, “Conflicting Signals for the Trustees’ Duty to Invest” (1996) 24(2) Austl. Bus. L. Rev. 140.

(a) for one or more of the following purposes:

- (i) the provision of benefits for each member of the fund on or after the member's retirement from any business

The SIS Act also mandates that funds implement specific investment principles. These include acting in the best interests of the beneficiaries, diversifying investments, and ensuring the fund can discharge its existing and prospective liabilities to manage reserves responsibly.¹⁷³ These provisions draw on the common law duties of trustees to invest prudently and loyally for the benefit of the fund members. Overall, then, it would seem that the trustee of a superannuation fund must ensure that the fund is maintained *solely* for generating and providing monetary benefits¹⁷⁴ to members upon retirement, which cannot be overridden by the terms of a fund's trust deed.¹⁷⁵

Non-adherence of this sole purpose standard might therefore occur where there is no retirement purpose behind an investment. For instance, a commentator for the Australian Council of Superannuation Investors advises: "an investment in an environmentally screened portfolio that is not expected to provide a return to members but rather fund anti-logging protest activities would be blatantly inconsistent with the sole purpose test".¹⁷⁶ The former Insurance and Superannuation Commission viewed section 62 as excluding non-financial investment criteria unless they were material to financial risk.¹⁷⁷

¹⁷³ SIS Act, ss. 7 and 52(2).

¹⁷⁴ The statute does not however define "benefits", though it can be implied that benefits are of a monetary kind.

¹⁷⁵ SIS Act, ss. 7 and 52. In the absence of express incorporation, section 52 of the SIS Act deems such covenants as included in the governing rules of the fund.

¹⁷⁶ P. Spathis, "Corporate Governance and Superannuation Trustees" (Dec. 2001) *Corporate Citizenship: A Newsletter of the Australian Council of Superannuation Investors* 32-33.

¹⁷⁷ Insurance and Superannuation Commission (ISC), *Superannuation Circular III.A.4. The Sole Purpose Test and Ancillary Purposes* (Canberra: ISC, 1995). Within Australia, the Accounting Standard 1031 provides guidance on quantitative thresholds for determining the materiality of an item such as environmental risk. Issued by the Australian Accounting Standards Board, the Standard 1031 defines materiality as meaning: "that information which if omitted, misstated or not disclosed has the potential to adversely affect decisions about the allocation of scarce resources made by users of the financial report or the discharge of accountability by the management or governing body of the entity".

However, Leigh contends that section 62 of the SIS Act can be interpreted to allow trustees to make non-financial considerations.¹⁷⁸ He argues the test under section 62 should be interpreted as a *dominant purpose* (rather than a sole purpose)¹⁷⁹ which enables superannuation fund trustees to take social or environmental factors into account. Their “dominant” goal must be the provision of monetary benefits to members upon retirement. Leigh creatively argues that another way for superannuation fund managers wishing to invest ethically to comply with section 62 would be to interpret “purpose” as an *end* rather than a *means*.¹⁸⁰ He cites the judgment of Davies J. in *Raymor Contractors Pty Ltd. v. Federal Commissioner for Taxation*, who stated: “[T]he word ‘purpose’ has a meaning which is readily understood. It refers to the end in view. When used in a statute, the term requires an act or transaction to have the object of achieving the end specified by the statute”.¹⁸¹ Similarly, Leigh contends that SRI is simply a means to an end (*i.e.*, the provision of retirement benefits to members), rather than an end in itself.

It can also be argued that the 2001 amendments to the *Corporations Act*, introducing UK-style obligations regarding mandatory disclosure of any environmental or ethical investment policy, implicitly authorize SRI. The nature of this seminal reform is examined later in this article. Another key recent reform is the *Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2005*. Since July 1, 2005 employees have been allowed to choose where their contributions to superannuation funds are invested. It enables employees to choose superannuation funds that adopt SRI strategies. Several companies and organizations were already offering SRI options before the legislative amendment.¹⁸²

Even though neither of these two reforms speaks directly to fiduciary responsibilities, they imply that SRI is a perfectly acceptable form of pension fund investment. Some lawyers doubt that the courts would

¹⁷⁸ Leigh, *supra*, n. 172 at 343.

¹⁷⁹ Leigh cites the judgment of Pincus J. in *Federal Commissioner for Taxation v. Roche* (1991), A.T.C. 5024 at 5027, as supporting this interpretation of s. 62.

¹⁸⁰ Leigh, *supra*, n. 172 at 343.

¹⁸¹ (1991), A.T.C. 4259 at 4260.

¹⁸² For example, the Health Employees Superannuation Trust of Australia (HESTA) offers an environmental screened investment strategy in a choice of options that commenced in early 2000, online: <www.hesta.com.au>.

accept that argument. Donnan points out that the *Corporations Act* disclosure laws relate only to disclosure and not to the broader regulatory regime and general legal principles under which funds operate.¹⁸³

The Australian superannuation industry has become more tolerant of SRI after years of disinterest or even opposition. According to an advisory statement of the Association of Superannuation Funds of Australia, the main requirements for a fund desiring to invest ethically are:¹⁸⁴

i. Unreduced expected return

An SRI policy must not lower the expected return of the plan's assets. If the plan carried an expected return shortfall against the broad market, it would be difficult for trustees to justify this policy while at the same time proving they are acting in the best interests of the plan beneficiaries.

ii. Effective diversification

Restrictions imposed by the SRI policy should not be so constraining that the fund is inadequately diversified.

iii. Implementability

Trustees need to check whether the policy can be implemented without introducing unacceptable risk exposures and burdensome administrative procedures. For example, some SRI policies lead to a portfolio biased towards medium and smaller capitalisation companies, introducing an element of risk into a portfolio and leading to periods of under-performance, even if there is no loss of long-term expected return.

iv. Member acceptance

Trustees must ensure that an SRI policy has wide acceptance from members, otherwise they risk assuming their social, ethical and environmental views are shared by the membership.

v. Documentation

Adequate and up-to-date documentation is vital and trustees should maintain proper records of their decisions and the grounds on which they are made. Independent investment advisers also have an important role to play in providing advice and independent view.

These are expectations that would also seem applicable to other jurisdictions.

¹⁸³ J. Donnan, "Regulating ethical investment: Disclosure under the Financial Services Reform Act" (2002) 13(3) *Journal of Banking and Finance Law and Practice* 155 at 170.

¹⁸⁴ Association of Superannuation Funds of Australia (ASFA), "Development of ASFA Policy on 'Ethical Investment'" (Sydney: ASFA, October 2000) 8.

(e) Conclusions

While no common law jurisdiction formally prohibits pension funds from socially responsible investing, some investment advisors and legal commentators see the governing legal principles as precluding SRI. However, the extant case law hardly supports this view. The acceptability of SRI will surely widen if SRI funds consistently match or exceed the returns of other investment choices.¹⁸⁵

Preferably pension funds wishing to invest responsibly should have an explicit mandate in their governing plan thereby avoiding potential legal obstacles. Trustees exercising fiduciary investment powers must exercise those powers for the purpose for which they were granted.

Where there is no express SRI mandate, fiduciary obligations would appear to be satisfied so long as: the SRI policy is not predicted to unduly lower the expected return of the pension plan's assets; there is sufficient portfolio diversification; trustees have taken proper investment advice and have consulted with their fund membership; and, the policy can be implemented without burdensome and costly administrative procedures. Alternatively, a pension fund could follow a standard investment process but rely on shareholder engagement to influence companies to improve their environmental and social performance.

5. REFORMING FIDUCIARY RESPONSIBILITIES FOR SRI**(a) Underlying Principles**

While the preceding discussion reveals to some extent a synergy between fiduciary investment standards and SRI in the pension sector, SRI remains pitifully small and pension fund trustees are still often taciturn to invest responsibly. Arguably, market forces rather than law itself poses the greatest hindrance to SRI. Capitalism is intertwined with

¹⁸⁵ See, *e.g.*, M.V. Russo & P.A. Fouts, "A Resource-Based Perspective on Corporate Environmental Performance and Profitability" (1997) 40(3) *Academy of Management Journal* 534; J. James, "The Calculus of Conscience: Socially-responsible Investing can be both Profitable and Ethical" (2000) 156(6) *Times International* 33; R.M. Roman, S. Hayibor & R.A. Bradley, "The Relationship Between Social and Financial Performance: Repainting a Portrait" (1999) 38(1) *Business and Society* 109.

our worst environmental problems.¹⁸⁶ Growth of financial markets has been closely associated with more volatile, speculative and short-term investment, typically running counter to socially just and environmentally sustainable development.¹⁸⁷

Some commentators nonetheless view pension funds as an exception to this malign view of the financial sector.¹⁸⁸ Pension funds are seen as an ideal vehicle for SRI because they have long-term financial liabilities that encourage long-term investment horizons. They do not compete for business (unlike retail mutual funds), they cater to ordinary workers, and they are typically not tainted by collateral business ties to their investee companies (unlike the case of banks and insurance companies that may offer additional business services to clients they finance – though with the integration of the financial sector in the early 1990s, banks and insurance affiliates are also starting to manage pension funds). However, this optimistic view does not take into account the practice of pension funds to invest through intermediaries such as asset management companies.¹⁸⁹ These financial intermediaries tend to have much narrower and short-term investment perspectives.

Relying on a free market approach to SRI in the pensions sector (and among other institutional investors) is of concern. Capital markets systematically fail to address many social and environmental costs. Numerous studies highlight market failures to acknowledge environmental impacts, including undervaluing ecological properties, and discounting future environmental costs and benefits.¹⁹⁰ Because the financial sector promotes and profits from economic growth, it should share

¹⁸⁶ See especially J. McMurtry, *The Cancer Stage of Capitalism* (London: Pluto Press, 1998).

¹⁸⁷ A. Harmes, *Unseen Power: How Mutual Funds Threaten the Political and Economic Wealth of Nations* (Toronto: Stoddard, 2001) at 76; K.A. Froot, D.S. Scharfstein & J.C. Stein, “Herd on the Street: Informational Inefficiencies in a Market with Short-Term Speculation” (1992) 47 *Journal of Finance* 1461; R.J. Shiller, *Irrational Exuberance* (Princeton: Princeton University Press, 2000).

¹⁸⁸ I. Carmichael, *Pension Power: Unions, Pension Funds, and Social Investment in Canada* (Toronto: University of Toronto Press, 2005).

¹⁸⁹ C. Mackenzie, “The Scope for Investor Action on Corporate Social and Environmental Impacts”, in R. Sullivan & C. MacKenzie (eds.) *Responsible Investment* (Sheffield: Greenleaf Publishing 2005) 20.

¹⁹⁰ See R. Costanza, et al., *An Introduction to Ecological Economics* (Boca Raton: St. Lucie Press, 1997).

responsibility for ensuring such development meets society's environmental and social goals and standards.¹⁹¹ If investors were more sensitive to sustainable development, then probably so too would the companies in which they invest.

Presumably, if market regulation were perfect, in the sense that businesses were required to account for all of their social and environmental impacts, then there would probably not be an SRI movement as we know it. There would be little need for SRI, as the value of companies would reflect their full social and environmental costs and benefits. SRI would be confined to addressing corporate governance failures and a small purely ethical investment sector making investments on religious and other ethical grounds with little regard for financial considerations.

For several reasons, attacking the problem directly by prohibiting harmful corporate behaviour through regulation has proven an insufficient solution. Financial markets are global, and pension funds like other financiers invest increasingly in international markets beyond the reach of home state regulation. For instance, Canada cannot regulate environmental activities of non-Canadian companies operating in other countries. However, they may be able to influence their activities by targeting Canadian-based financial sponsors. But even within narrower and easier parameters of domestic social and environmental regulation, governments have failed to realign economies towards sustainable development worldwide.¹⁹² Despite several decades of legislative reform, major international environmental studies testify to continuing environmental decline in nearly all countries.¹⁹³ Perhaps a new approach that targets the underlying processes of capital allocation may make more significant progress.

For the state to direct the allocation of capital in support of social and environmental causes would be politically unviable. It could also engender major economic inefficiencies given that regulators typically

¹⁹¹ See J. Rada & A. Trisoglio, "Capital Markets and Sustainable Development" (1992) 27(3/4) *Columbia Journal of World Business* 42; W.L. Thomas, "The Green Nexus: Financiers and Sustainable Development" (2001) 13 *Geo. Int'l Envtl. L. Rev.* 899.

¹⁹² See especially B.J. Richardson & S. Wood (eds.), *Environmental Law for Sustainability: A Reader* (Oxford: Hart Publishing, 2006).

¹⁹³ See, by way of introduction, Worldwatch Institute, *The State of the World 2003* (Washington DC: Worldwatch Institute, 2003).

lack the required information and expertise. Financial reform in OECD countries has tended to heed the “financial repression” thesis, namely, that state economic intervention to control where money flows, risks provoking capital flight, fragmented markets and other inefficiencies.¹⁹⁴ In such a hazardous regulatory and political milieu, SRI-based regulation should probably aim (at least for the moment) to promote informational, incentive and other procedural mechanisms to nurture the conditions for SRI among pension funds and other investors. However, if the gravity of our social and environmental problems worsens, more interventionist reforms to promote SRI may be viable. The following sections canvass potential reforms.

(b) SRI as a “Material” or Discretionary Concern

Fiduciary duties are not static, and have evolved to reflect changing social norms and values. Over fifty years ago, for instance, fiduciary duties were held by British courts to preclude municipal authorities from applying a standard minimum wage for adult men and women and providing subsidized public transport.¹⁹⁵ In this vein, fiduciary duties can be reformed again to address SRI considerations.

Regulation to encourage SRI could enable institutional investors, even without an explicit mandate by contract or trust deed, to lawfully take social, ethical and environmental factors into account, if such factors have a material bearing on financial returns and risks.¹⁹⁶ For example, trustees of a pension fund seeking long-term investments that take account of future climate change risks might favour shifting investments from fossil fuel industries to some emerging renewable energy technology firms. Presently, such investments may seem too remote and speculative. Under this model, SRI can be sanctioned as a permissible method where social and environmental factors have a *material* bearing on

¹⁹⁴ See E.S. Shaw, *Financial Deepening in Economic Development* (Oxford: Oxford University Press, 1975); G. Yago, “Financial Repression and the Capital Crunch Recession: Political and Regulatory Barriers to Growth Economics” in B.S. Zycher & C. Lewis, eds., *Economic Policy, Financial Markets, and Economic Growth* (Boulder: Westview Press, 1993) 81.

¹⁹⁵ See *Roberts v. Hopwood*, [1925] A.C. 578 (U.K. H.L.); *Prescott v. Birmingham Corp.*, [1955] Ch. 210 (U.K.).

¹⁹⁶ Brokerage House Analysts, *The Materiality of Social, Environmental and Corporate Governance Issues to Equity Pricing* (Geneva: UNEP Finance Initiative, 2004).

financial returns in the short or long-term. The materiality threshold test is allowable now, but policy reform can encourage it.

Some jurisdictions have also legislated to allow SRI as a discretionary concern. In Canada, lawmakers in Manitoba and Ontario have encroached on traditional formulations of trustees' fiduciary duties. In 1993, the Manitoba Law Reform Commission recommended that the province amend its legislation to permit trustees to consider non-financial criteria in their investment policies.¹⁹⁷ In 1995, Manitoba's *Trustee Act* was amended to provide:¹⁹⁸

Subject to any express provision in the instrument creating the trust, a trustee who uses a non-financial criterion to formulate an investment policy or to make an investment decision does not thereby commit a breach of trust if, in relation to the investment policy or investment decision, the trustee exercises the judgment and care that a person of prudence, discretion and intelligence would exercise in administering the property of others.¹⁹⁹

In 2005, a similar provision was introduced into Manitoba's pension legislation, thereby allowing non-financial investment considerations.²⁰⁰

Ontario's reform was more specific and discrete. In 1990, the province enacted the *South African Trust Investments Act* to discourage Ontarian companies from investing in an apartheid system. The Act permitted a trustee to divest or reject investments in companies doing business in South Africa without infringing their duty.²⁰¹ The Ontario reform is significant because it sanctioned divestments even though it could have an *adverse* effect on investment returns. However, the legislation stipulated that trustees could not take such actions without the consent of a majority of their beneficiaries.²⁰² Though, like the Mani-

¹⁹⁷ Manitoba Law Reform Commission, *Ethical Investment by Trustees* (Winnipeg: Manitoba Law Reform Commission, 1993) 32.

¹⁹⁸ *The Trustee Act*, R.S.M. 1987, c. T160, s. 79.1.

¹⁹⁹ Other Canadian provinces have not followed the Manitoban precedent. The British Columbia Law Institute, however, advised its province against adoption of the Manitoba law change because "application of non-financial criteria must be authorized by the terms of the trust if the trustees are to be excused from liability for obtaining a lower return than conventional financial investment criteria would produce": Trustee Act Modernization Committee, *Report on Trustee Investment Powers* (Vancouver: British Columbia Law Institute, April 1999) 19.

²⁰⁰ *The Pension Benefits Act*, R.S.M. 1987, c. P32, s. 28.1(2.2).

²⁰¹ *South African Trust Investments Act*, R.S.O. 1990, c. S.16, s. 3.

²⁰² *Ibid.*, s. 4.

toban reform, Ontario's initiative did not actually mandate SRI – it remained a discretionary consideration for investors.

In the governmental occupational pension sector, some jurisdictions have also legislated to allow for SRI. Connecticut state law for instance provides that state pension fund fiduciaries may consider the environmental and social implications of investments, including decisions related to individual securities or types of securities.²⁰³

The Canada Pension Plan (CPP)²⁰⁴ has recently revised its investment policy to incorporate policies on social and environmental investment and corporate engagement. The CPP Investment Board's *Policy on Responsible Investing*, issued in October 2005, provides that the principles to guide its investments include:

- Recognizing that the importance of environmental, social and governance (ESG) factors varies across industries, geography and time, responsible corporate behaviour with respect to ESG factors can generally have a positive influence on long-term corporate behaviour.
- Investment analysis should incorporate ESG factors to the extent that they affect long-term risk and return.²⁰⁵

The CPP Investment Board's "overriding" responsibility remains however to "maximize investment returns without undue risk".²⁰⁶ But the fact that the CPP Investment Board has begun (albeit belatedly) to recognize the materiality of SRI issues without any amendment to its legislative charter is significant.

(c) The Disclosure Approach

Another way by which pension funds could become an instrument of environmental and social change is through legislative requirements

²⁰³ Conn. Gen. Stat. § 3-13d(a) (2002).

²⁰⁴ The CPP is a contributory, earnings-related social insurance program, managed by the federal government. It can provide additional retirement income in addition to earnings from private pension plans. See further, online: <www.sdc.gc.ca/en/isp/cpp/cpptoc.shtml>.

²⁰⁵ Canada Pension Plan Investment Board (CPPIB), *Policy on Responsible Investing* (Ottawa: CLLIB, Oct. 2005) 2. The CPP was previously criticized for some socially irresponsible investments: T. Flynn, "War and Weapons Funded by Canada Pension Plan" (2004) 30(4) Alt. J. 16.

²⁰⁶ *Ibid.*, at 2.

for trustees and their agents to publicly report on their policies in this respect. The reporting process can heighten public expectations that pension funds should adopt an SRI policy, and can have pedagogic value to fund trustees themselves.

The UK was the first country to take a tentative step in this direction. In July 1999, the government issued a regulation under the *Pensions Act 1995* requiring occupational pension fund trustees to disclose their policies, if any, on SRI and on the exercise of shareholder rights, including voting rights.²⁰⁷ A similar requirement was imposed on local government pension funds.²⁰⁸

The UK example stimulated similar reforms in several European countries and Australia.²⁰⁹ Legislation requiring pension funds to disclose environmental, social or ethical considerations in their investment policies was enacted in several EU states including Belgium,²¹⁰ France,²¹¹ and Germany.²¹² In Australia, legislation adopted in 2001 applied an SRI disclosure obligation on a wider range of investment products than found in the European examples, covering pensions, retail mutual funds and investment life insurance products.²¹³ At the time, the Association of Superannuation Funds of Australia declined to support it, and in a staff paper it was argued “there were currently no definitions

²⁰⁷ Enacted pursuant to *Pensions Act 1995*, c. 26, s. 35(3)(f): *Occupational Pension Schemes (Investment, and Assignment, Forfeiture, Bankruptcy etc.), Amendment Regulations 1999*, cl. 2(4). Now contained in the *Occupational Pension Schemes (Investment) Regulations 2005*: cl. 2(3)(b)(vi)-(3)(c).

²⁰⁸ *Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 1999*.

²⁰⁹ *The Financial Services Reform Act 2001(Cth)* introduced a new part 7 into the *Corporations Act*, which contains the reform in question. See B.J. Richardson, “Pensions Law Reform and Environmental Policy: A New Role for Institutional Investors?” (2002) 3(5) *Journal of International Financial Markets: Law and Regulation* 159.

²¹⁰ Law of April 28, art. 42(3), *Moniteur Belge* (2d ed.), May 15, 2003, at 26, 407 (Belg.).

²¹¹ *Projet de loi sur l'épargne salariale*, 7 Feb. 2001. No.2001-152, art. 2; *Projet de loi portant diverses dispositions d'ordre social, éducatif et culturel*. 28 June 2001, Chapitre Vbis, art. L.135-8.

²¹² *Betriebliche Altersvorsorge*: art. 10, *Änderung des Versicherungsaufsichtsgesetzes*.

²¹³ *Corporations Act 2001*, s. 1013D(1)(l). See further B.J. Richardson, “Ethical Investment and the Commonwealth’s Financial Services Reform Act 2001” (2002) 2 *National Environmental Law Review* 47.

for the terms *environmental*, *social* or *ethical*, and therefore the requirement was likely to be misused and misleading”.²¹⁴ None of these disclosure reforms statutorily define what constitutes “socially responsible investment” or similar concepts, and only Australia provides substantive guidance from the regulator.²¹⁵

As to implementation, a 2003 study of the UK reform by the Ethical Investment Research Service found that 90 percent of UK pension funds disclosed in their statement of investment principles what they considered social, environmental and ethical policies.²¹⁶ Another study in 2004 reported a large increase in ethical investing by UK pension funds, though it could not observe or claim a causal relationship between this and the change in law.²¹⁷ It also suggested however that UK pension funds were not actively monitoring companies’ compliance with social and environmental policies.²¹⁸ In 2004, the Australian Conservation Foundation (ACF) undertook a study of Australia’s top 25 investment managers’ compliance with the SRI policy disclosure regulation. The ACF found that “many mainstream investment managers still do not appreciate the relationship between ethical corporate behaviour and long-term financial performance”.²¹⁹ Further reform may therefore be

²¹⁴ Association of Superannuation Funds of Australia (ASFA), *Development of ASFA Policy on “Ethical Investment”* (Sydney: ASFA, Oct. 2000) 4.

²¹⁵ The Australian Securities and Investment Commission (ASIC) in 2005 released binding regulations for issuers of investment product disclosure statements (PDS). The regulations apply in cases where a PDS claims that labour standards or environmental, social or ethical standards have been taken into account in investment decisions. The guidelines require investment product issuers to provide clients with sufficient detail regarding the methodology for taking the relevant standards or considerations into account; any weighting system used with respect to the standards and considerations; and a description of the product issuer’s retention and realization policies. The PDS must include a general description of whether adherence to the methodology will be monitored or reviewed, and an explanation of what will happen when an investment no longer matches the stated investment policy. ASIC, *Disclosure: Product Disclosure Statements (and other disclosure obligations)* (Canberra: ASIC, May 2005).

²¹⁶ Ethical Investment Research Service (EIRIS), *How Responsible is Your Pension?* (London: EIRIS, 2003).

²¹⁷ D. Wheeler & J. Thomson, *Comparative Study of U.K. and Canadian Pension Fund Transparency Practices* (Ottawa: NRTEE, 2004) 18.

²¹⁸ *Ibid.*, at 20.

²¹⁹ C. Berger, *Disclosure of Ethical Considerations in Investment Product Disclosure*

needed to devise suitable sanctions and remedies should pension fund managers and trustees fail to invest according to their SRI statements.

In Canada, the Social Investment Organization has been lobbying for change, and it supported an attempt to pass a private member's bill modelled on the UK law. In September 2002, Bloc Quebecois MP Stephan Tremblay introduced a bill to amend the *Pension Benefits Standards Act, 1985* to require federally regulated pension plans to disclose their policies, if any, on SRI.²²⁰

(d) Compulsory SRI

More forceful legal mechanisms may be more appropriate than merely allowing SRI where it meets "materiality" thresholds or requiring disclosure of applicable SRI policies. Each may fail to induce changes in long-standing investment practices. Policy-makers could insist that investors take social and environmental impacts into account as part of their fiduciary investment duties. This is not unprecedented, though rare given the political obstacles.

The precautionary principle could help shape such a restatement of fiduciary responsibilities. While many developed nations have subscribed to the precautionary principle in their environmental legislation,²²¹ they have not sought to operationalize it in the regulation of their capital markets. Given conditions of scientific uncertainty about the environmental effects of human development, the precautionary principle recommends we take preventative action before risks are conclusively established since delay may prove more costly to society and nature.²²²

Prudential investment standards governing fiduciaries could incorporate the precautionary principle. Operationalizing the precautionary

Statements: A Review of Current Practice in Australia (Melbourne: ACF, August 2004) 1.

²²⁰ Bill C-394, *An Act to amend the Pension Benefits Standards Act, 1985*.

²²¹ E. Hey, "The Precautionary Principle in Environmental Law and Policy: Institutionalising Precaution" (1994) 4 *Geo. Int'l Env'tl. L. Rev.* 303; E. Fisher, *et al.* (eds.), *Implementing the Precautionary Principle: Perspectives and Prospects* (Cheltenham: Edward Elgar, 2006).

²²² See J. Cameron & J. Abouchar, "The Precautionary Principle" (1991) 14 *B.C. Int'l & Comp. L. Rev.* 1; D. Bodansky, "Scientific Uncertainty and the Precautionary Principle" (1991) 33 *Environment* 4.

principle has proven exceptionally difficult in other policy contexts, and it would likely be so in the financial sector. A possible starting point would be to lower the thresholds that would trigger a requirement for fiduciary investors to respond to environmental risks. Rather than merely requiring a response where environmental threats seem sufficiently “material” to financial risks and returns, fiduciaries should take a longer term investment horizon, taking environmental hazards into account for which there may presently be much less certainty.

The precautionary principle is starting to get acknowledgement in some voluntary corporate codes of conduct,²²³ but it has yet to appear as a matter of practice in the financial services sector. The recent emergence of “weather derivatives” to hedge risk against natural disasters including climate change induced calamities does however encouragingly suggest that capital markets are experimenting with mechanisms to accommodate new types of environmental risks.²²⁴

At this time, few jurisdictions have imposed obligations in discrete contexts for institutional investors to consider social or environmental impacts. This has occurred mainly in the US state pension fund sector. During the 1980s various US states led by Connecticut forbade investment of state funds in companies doing business in South Africa unless the corporation adhered to the Sullivan Principles²²⁵ and had been rated a good performer under the Sullivan Principles scoring system.²²⁶ Massachusetts also directed its public pension funds not to invest in banks or other financial institutions that had outstanding loans to South Af-

²²³ E.g., *UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with regard to Human Rights*, E/CN.4/Sub.2/2003/12/Rev.2 of 26 August 2003, Article 14.

²²⁴ C. Dosi & M. Moretto, “Global Warming and Financial Umbrellas” (2003) 4(4) *Journal of Risk Finance* 18; R.S. Dischel & P. Barrieu, “Financial Weather Contracts and their Application in Risk Management” in R.S. Dischel (ed.), *Climate Risk and the Weather Market* (London: Risk Books, 2002) at 35.

²²⁵ The Sullivan Principles were drafted in 1977 by Leon Sullivan, a pastor and human rights activist, and posited voluntary labour standards for US companies operating in South Africa: H.J. Richardson, “Leon Sullivan’s Principles, Race and International Law: A Comment” (2001) 15 *Temp. Int’l & Comp. L.J.* 55.

²²⁶ Conn. Gen. Stat. § 3-13f (Supp. 1984); see further G. Jubinsky, “State and Municipal Governments React Against South African Apartheid: An Assessment of the Constitutionality of the Divestment Campaign” (1985) 54 *U. Cin. L. Rev.* 453.

rica.²²⁷ Some city governments also enacted ordinances to give similar effect to the Sullivan Principles.²²⁸ The validity of the US examples from a fiduciary duty perspective was upheld in the *Baltimore (City)* case, as discussed earlier.²²⁹ The federal government also got involved pursuant to the *Comprehensive Anti-Apartheid Act of 1986*,²³⁰ which prohibited new US investment in apartheid South Africa and required American businesses with more than 25 employees in South Africa to comply with the Sullivan Principles.²³¹

During this period, some US states also legislated to apply the MacBride Principles,²³² prohibiting state funds from investment in corporations doing business in Northern Ireland that did not promote equal hiring practices and the security and safety of employees.²³³ Over 15 states and the federal Congress have enacted MacBride legislation.²³⁴

Outside of the US, Swedish, Norwegian, New Zealand and French national pension schemes have recently been amended by legislation to direct their funds towards SRI goals.²³⁵ French legislation governing the

²²⁷ Mass. Ann. Laws ch. 32, § 23(1)(d)(ii) (Supp. 1984).

²²⁸ Jubinsky, *supra*, n. 226.

²²⁹ 317 Md. 72, 562 A.2d 720 (1989).

²³⁰ Pub. L. No. 99-440, 100 Stat. 1086 (1986), codified at 22 U.S.C. §§ 2151, 2346(d), 5001-5116 (Supp. IV 1986).

²³¹ Some US states have tried to legislate certain other restrictions on how state funds are invested. Texas enacted a law in 1997 which forbids state entities from investing in any company that owns at least 10% of a business that records or produces certain kinds of music deemed offensive by the statute (*e.g.*, promotes illegal drug use and racially-motivated violence): N. Strauss, "Texas Bans Investment in Explicit Recordings" (June 21, 1997) *New York Times*, section 1 at 13.

²³² The MacBride Principles, proposed by Seán MacBride, an international human rights activist, are a US corporate code of conduct drafted in 1984 to combat pervasive discrimination against Catholics in Northern Ireland: K.A. Bertsch & H.E. Booth, *The MacBride Principles and U.S. Companies in Northern Ireland* (New York: Investor Responsibility Research Centre, 1991).

²³³ See C. McCrudden, "Human Rights Codes for Transnational Corporations: What Can the Sullivan and MacBride Principles Tell Us?" (1999) 19(2) *Oxford J. Legal Stud.* 167; N.J. Conway, "Investment Responsibility in Northern Ireland: The MacBride Principles of Fair Employment" (2002) 24 *Loyola of Los Angeles International and Comparative Law Review* 1.

²³⁴ K.A. Burke, "Fair Employment in Northern Ireland: The Role of Affirmative Action" (1994) 28 *Colum. J.L. & Soc. Probs.* 1, 12.

²³⁵ J. Myles & P. Pierson, "The Comparative Political Economy of Pension Reform" in P. Pierson (ed.), *The New Politics of the Welfare State* (Oxford: Oxford University Press, 2001) 305.

Retirement Reserve Funds (Fonds de Réserve Pour Les Retraites) obliges fund managers to consider environmental and social issues in investment decisions.²³⁶ Under the *Swedish National Pension Funds Act of 2000*, “environmental and social considerations shall be taken into account in investment activities without impinging on the overall goal of a high return on capital”.²³⁷ The five national pension funds have since revised their investment policies to promote SRI.²³⁸ New Zealand’s *Superannuation and Retirement Income Act 2001* specifies that a “statement of investment policies, standards, and procedures must cover ... ethical investment, including policies, standards, or procedures for avoiding prejudice to New Zealand’s reputation as a responsible member of the world community”.²³⁹ The Guardians of the New Zealand Superannuation Fund have been slow to develop their SRI policy, and as of early 2006 no company or country had been excluded from investment on ethical grounds.²⁴⁰

Most recently, the Norwegian Government Public Pension Fund²⁴¹ was established on January 1, 2006 with an SRI mandate. The Fund’s “Ethical Guidelines”, adopted by government regulation, state that the Fund: “should not make investments which constitute an unacceptable risk that the Fund may contribute to unethical acts or omissions, such as violations of fundamental humanitarian principles, serious violations of human rights, gross corruption or severe environmental damages”.²⁴²

²³⁶ The relevant part of the French law provides: ‘Il met en oeuvre les orientations de la politique de placement. Il controle le respect de celles-ci. Il en rend compte régulièrement au conseil de surveillance et retrace notamment, a cet effet, la manière dont les orientations générales de la politique de placement du fonds ont pris en compte des considérations sociales, environnementales et éthiques’: Loi N° 2001-624 du 17 juillet 2001 portant diverses dispositions d’ordre social, éducatif et culturel. Art. L.135-8.

²³⁷ Sweden Government Bill 1999/2000: 46, “The AP Fund in the Reformed Pension System” (January 13, 2000), s. 7.1.

²³⁸ E.g., Trejde AP-fonden, *Third Swedish National Pension Fund: Annual Report 2004* (Stockholm: Trejde AP-fonden, 2005) 22 (emphasizing corporate engagement rather than screening methods of SRI).

²³⁹ Section 61(d).

²⁴⁰ Interview, Paul Costello, CEO, Guardians of the New Zealand Superannuation Fund (December 2005).

²⁴¹ The Fund incorporated the existing Government Petroleum Fund and the National Insurance Scheme Fund, which already had some SRI policies.

²⁴² *Issued December 22 2005 pursuant to regulation on the Management of the Gov-*

The Ethical Guidelines elaborate that the Fund will apply negative screening and exercise asset ownership rights as the core methods of SRI. Unlike the New Zealand Fund's timid approach to SRI, the Norwegian Fund has already started to exclude problematic businesses, such as Wal-Mart for its allegedly harsh labour practices.²⁴³

As progressive as these investment reforms might seem, we must recognize that they only target public pension funds. No government has yet been so bold as to mandate SRI for private pension plans.

(e) Other Incidental Reforms

Getting pension fund trustees to invest responsibly is not just a matter of blunt regulation. It also requires a policy framework that can improve how trustees are selected and educated, as well as how they interact with pension plan beneficiaries. These should be treated as relevant ancillary components of fiduciary investment responsibilities.

Accordingly, pension fund trustees should be more accountable to fund membership so that their investment policies are aligned with beneficiaries. To achieve this, lawmakers should ensure that employees and retirees have the right to elect a given percentage of trustees.²⁴⁴ They should be elected at periodic public meetings with full disclosure of their qualifications and professional experience. Aside from elections, governments should consider mandating that investment policies be regularly ratified by fund member votes. Such reforms would help to give effect to the contractual nature of pension funds.

Pension trustees may lack the necessary expertise about SRI. Many trustees need training and education in this field. Several SRI think-tanks now actively promote pension trustee education and training on SRI issues.²⁴⁵ Public policy should require new forms of trustee training,

ernment Pension Fund (2004), online: <http://odin.dep.no/fin/english/topics/pension_fund/p10002777/guidelines/bn.html>.

²⁴³ B. Baue, "Norwegian Government Pension Fund Dumps Wal-Mart and Freeport on Ethical Exclusion" *Social Funds* (June 16 2006), online: <www.socialfunds.com/news/article.cgi?sfArticleId=2034>.

²⁴⁴ This occurs to some extent in some jurisdictions, e.g., UK's *Pensions Act 1995*, s. 16 (under new amendments employers will no longer be able to opt out of the member-nominated trustees provisions); and Canada's *Pension Benefits Standards Act, 1985*, s. 7.1.

²⁴⁵ E.g., European Social Investment Forum (EUROSIF), *Pension Programme: SRI*

certification, disclosure and ethics, including exposure to current research on the financial significance of SRI. Relevantly, the UK's *Pensions Act* was amended in 2004 to require trustees to attain a certain level of knowledge and understanding of the trust deed and rules, the law relating to pensions and trusts and the "principles relating to the funding of occupational pension schemes and investment of assets of such schemes".²⁴⁶ Such higher standards should enable trustees to better undertake the challenge of SRI.

Finally, pension trustees should also be compelled by legislation to inform and consult with fund beneficiaries and to consider their views. It should explicitly form part of their fiduciary responsibilities to actively inform and consult. Presently, absent an express requirement in the trust document, there is no general common law onus on trustees to take the initiative to inform, or consult with, the beneficiaries about the administration of the trust.²⁴⁷ Trustees do however have obligations to respond to requests by beneficiaries for information.²⁴⁸ Pension legislation is evolving to impose a duty on employers to actively inform plan members. Canadian pension legislation for instance gives plan members the right to receive certain information at regular intervals and upon request.²⁴⁹ The European Union's Occupational Pensions Fund Directive – applicable to the UK – also introduces high standards for provision of information to plan members.²⁵⁰

Consultation rights are less commonly provided. The UK is amending its pension legislation to prescribe new consultation procedures with plan members where employers propose "significant" changes to company pension plans.²⁵¹ Consultation can help inform SRI choices, espe-

Toolkit 2004-05 (Paris: EUROSIF, 2005); C. Higgs & H. Wildsmith, *Responsible Investment Trustee Toolkit* (London: JustPensions, 2005).

²⁴⁶ *Pensions Act 2004*, c. 35, s. 247(4).

²⁴⁷ J.E. Martin, *Hanbury and Mandsley: Modern Equity*, 16th ed. (London: Sweet and Maxwell, 2001) at 524.

²⁴⁸ This right was affirmed as long ago as *Walker v. Symonds* (1818), 3 Swans. 1, 36 E.R. 751 (U.K.) at 58 [Swans.]. See further, for more contemporary jurisprudence, M. Thomas, "The Disclosure of Trust Documents in Occupational Pension Schemes" [1997] J. Bus. L. 514.

²⁴⁹ Kaplan, *supra*, n. 109 at 214-16.

²⁵⁰ Article 11, *supra*, n. 66.

²⁵¹ *The Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations, 2006/349*.

cially on controversial ethical issues such as investment in gambling or armaments production. While unanimity among plan members on ethical and other SRI issues will usually be hard to establish, participants could at least identify those issues about which a substantial majority of the plan members feel strongly.

6. CONCLUSION: THE FUTURE OF INVESTORS' FIDUCIARY DUTIES

This article seeks to clarify the impact of fiduciaries' investment duties in the pension fund sector on SRI. Traditionally, those fiduciary duties are seen as antithetical to SRI, primarily because ethically-motivated investing is stereotyped as sacrificing financial returns. This article disputes this dichotomy, arguing that SRI is often financially advantageous and can be implemented by various methods that comply with duties of prudence and loyalty. Depending on how the "best interests" of beneficiaries are defined, SRI may even allow for some diminution of financial returns in order to achieve specific ethical or social benefits mandated by governing trust instruments.

Fiduciary duties of pension funds have evolved over the centuries to reflect modern investment practices. They are evolving again to reflect impacts of environmental and social concerns on corporate financial performance. Today, the financial world is belatedly learning that good environmental performance can spur better financial performance, and it is imperative to have that reflected in fiduciary responsibilities. Failure to consider and act on environmentally and socially related information is not prudent in the financial sense of the word and should not be treated as prudent in the legal sense either. Correctly formulated and applied, investors' fiduciary duties should aid rather than hinder SRI.

The enunciation of fiduciary duties in major common law jurisdictions hardly poses a serious hindrance to SRI. There is a paucity of case law and few judicial or regulatory precedents that hamper SRI. Certainly, some pension plans are actively addressing social and environmental issues in their investment policies, and so far without adverse legal consequences.²⁵² In Canada, the Ontario Municipal Employees Retire-

²⁵² For evidence, see Mercer Investment Consulting, *Perspectives on Responsible Investment: A Survey of US Pension Plans, Foundations and Endowments, and Other Long-Term Savings Tools* (Toronto: Mercer Investment Consulting, 2006); UK

ment System (OMERS) is one of a growing cluster of public sector occupational pension plans that have embraced an SRI policy and publicly report on how they vote on all proxy contests.²⁵³ Similarly, the Ontario Public Services Employees Union's (OPSEU) Pension Trust is also emerging as a major campaigner for corporate environmental and social responsibility.²⁵⁴ In the US, the California Public Employees Retirement System and the New York State Public Employees Retirement System are among the leaders in responsible fiduciary activism.²⁵⁵

Yet, in many other cases, conservative pension plan trustees and their fund managers resist change.²⁵⁶ If market forces or voluntary commitments alone prove too tepid to spur change, then governments may need to make surgical adjustments to pension laws and other regulations to foster SRI. This article has canvassed various options, ranging from discrete to highly interventionist mechanisms.

Encouragingly, the recently enacted United Nations (UN) Principles of Responsible Investment have been enthusiastically endorsed by

Social Investment Forum, "Growth in Institutional SRI", online: <www.uksif.org/Z/Z/Z/inst/grow/index.shtml>; A. Pappmehl, "Sustainable Development and Your Portfolio: Does It Make Sense to Invest in a Company Known for Bad Environmental or Labour Practices? An Increasing Number of Pension Fund Managers Think Not" (2002) 26(12) Benefits Canada.

²⁵³ OMERS, "Statement of Investment Policies and Procedures for the Ontario Municipal Employees Retirement System" (January 2003), online: <www.omers.com/investments/statementofinvp.html#social>. OMERS, "Proxy Voting Guidelines" (January 2002), online: <www.omers.com/investments/proxyvoting_guidelines/E-intro.htm>.

²⁵⁴ OPSEU, "OPSEU Policy Statement with respect to Union Appointed Trustees and Sponsors for Jointly Trusteed Pension Plans" (OPSEU, n.d.), online: <www.opseu.org/benefit/policystatement.htm>.

²⁵⁵ M. Cohen, "Evidence of a New Environmental Ethic: Assessing the Trend Towards Investor and Consumer Activism" in I. Jones & M. Pollitt (eds.), *The Role of Business Ethics in Economic Performance* (New York: St Martin's Press, 1998) 111 at 117.

²⁵⁶ See World Business Council for Sustainable Development, *Generation Lost: Young Financial Analysts and Environmental, Social and Governance Issues* (Geneva: UNEP Finance Initiative 2004); S. Davis, 'Responsible Investment and Pension Funds', in *Mainstreaming Responsible Investment* (World Economic Forum, 2005) 41 at 43. Though some research suggests attitudes are changing: C. Gribben & M. Gitsham, *Will UK Pension Funds Become More Responsible? A Survey of Trustees* (London: JustPensions, 2006).

a number of the world's largest private and state pension funds.²⁵⁷ The UN Principles, adopted in March 2006, steer away from distinguishing between specific types of investments in favour of best practice standards for environmental assessment, shareholder activism, public reporting and other accountability measures.²⁵⁸ The preamble to the Principles proclaims: "As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios".²⁵⁹ Hopefully, therefore, the UN Principles will act as a catalyst to purge any remaining legal uncertainties on the place SRI warrants in the policies of pension plans and other investors.

Of course, many factors aside from fiduciary duties will have a crucial bearing on the prospects for SRI. This article has canvassed only one of those issues. Corporate governance, accountancy rules, the pricing of environmental resources and risks, taxation incentives for SRI, are just a few of the many other pressing policy issues that need attention to enable an SRI revolution.²⁶⁰

²⁵⁷ United Nations, Principles for Responsible Investment, online: <www.unpri.org>. The signatories include the Canada Pension Plan, British Telecom Pension Scheme, New Zealand Superannuation Fund, and the UK Universities Superannuation Scheme. See further signatories listed online: <www.unpri.org/signatories>.

²⁵⁸ The text of the Principles is available online: <www.unpri.org/principles>.

²⁵⁹ *Ibid.*

²⁶⁰ For analysis of some of these other policy challenges, see B.J. Richardson, "Sustainable Finance: Environmental Law and Financial Institutions" in Richardson & Wood, *supra*, n. 192 at 309; B.J. Richardson, "Financing Environmental Change: A New Role for Canadian Environmental Law" (2004) 49(1) McGill L.J. 145; B.J. Richardson, "Greening the Financial Sector: Legal Reforms in the European Union" in *Yearbook of European Environmental Law*, vol. 7 (Oxford: Oxford University Press) [forthcoming in 2007].