From Fiduciary *Duties* to Fiduciary *Relationships* for Socially Responsible Investment

BENJAMIN J. RICHARDSON *

Debates about the legality of socially responsible investing (SRI) with regard to institutional investors' fiduciary duties have focused on whether SRI is "financially material" to investment performance. This article examines the less considered question of whether SRI may also be legally permissible if it fulfills the *will of the beneficiaries* in a fiduciary relationship. It argues that by reframing fiduciary finance as an active *relationship* rather than merely the mechanical application of legal duties, we may allow trustees to invest socially pursuant to the wishes of beneficiaries. However, this article also suggests that considerable legal and practical obstacles confront this path to SRI. They include trustees' duty to treat different beneficiaries even-handedly and the traditionally passive role fiduciary law has cast beneficiaries. Reliance on widely-held social customs and evaluation of third parties' interests as a proxy for the will of beneficiaries, and the role of statutory reforms mandating consultation with and representation of beneficiaries on the governing boards of trustees, are also considered in this article. It concludes by suggesting some potential legal reforms to strengthen reliance on the will of beneficiaries as a means of SRI.

I. A NEGLECTED ASPECT OF FIDUCIARY FINANCE 1

II. THE TRUSTEE-BENEFICIARY LEGAL RELATIONSHIP 4
- A. The Passive Beneficiary 4
- B. Taking Instructions from Beneficiaries 7
- C. Acting Impartially 9

III. ASCERTAINING THE WILL OF BENEFICIARIES 11
- A. Finding Unanimity among Beneficiaries 11
- B. Following Social Customs 14
- C. Third Party Stakeholders 17
- D. Consultation with and Representation of Beneficiaries 19

IV. REFORMING FIDUCIARY FINANCE RELATIONSHIPS 23

V. CONCLUSION 26

I. A NEGLECTED ASPECT OF FIDUCIARY FINANCE

Can financial institutions subject to fiduciary duties engage in socially responsible investing (SRI) if it fulfills the will of their beneficiaries? Addressing both the legal and practical dimensions of this question, this article aims to resolve a relatively neglected aspect of fiduciary finance law.

While there has been a long-standing public debate regarding the legality of SRI, it has not examined all issues; it has focused on the "financial materiality" of environmental, social and governance (ESG) issues to investment performance as a legal justification for SRI.[1] But there has been little analysis of what weight should be attached to the views of beneficiaries in this regard.

The term "fiduciary" is an invention of Roman law and, as a noun, means a person holding the character of a trustee, being charged to act primarily for another's benefit with regard to specific property or affairs.[2] Among the various types of relationships that the law has characterized as having a fiduciary character are those that exist in investment institutions between those who manage the assets and the beneficiaries or members who contribute capital. At common law and in legislation, therefore, trustees, fund managers, advisors and certain other types of decision-makers may be impressed with fiduciary status and, consequently, owe specific obligations to beneficiaries. These obligations include a duty to act with loyalty for the benefit of the beneficiaries and a duty to act reasonably and prudently.[3]

The notion that fiduciary law may allow SRI to fulfill the wishes of the beneficiaries is a complex issue. Where investors act for themselves, there is of course no legal obstacle to SRI since a fiduciary relationship does not exist.[4] But where such a relationship governs investment decisions, if the beneficiaries are unanimous in their views about SRI, trustees may and perhaps even should take those views into account as part of their consideration of the beneficiaries' "best interests." However, some SRI issues involve deeply contested ethical dilemmas for which there is no established ethical custom, such as animal welfare, consumption of alcohol, and fertility control. On the other hand, some SRI issues involve market failures where the problem is not that an activity might be viewed as intrinsically objectionable, but rather the fact that there is too much of the activity occurring (e.g., emitting greenhouse gases, over-fishing and deforestation). Agreement on the need to control these activities might be more attainable, but there remain significant differences of opinion in how to do so and what should be the price for corrective action.

By focusing on the will of beneficiaries, in this article I wish to broaden the SRI debate beyond analysis of the interpretation fiduciary duties to consider also the implications of the fiduciary *relationship* between trustees

---

* Professor, Osgoode Hall Law School, York University, Canada. This article is submitted exclusively for the PRI Academic Conference, Copenhagen, 5-7 May, 2010.

1 Freshfields Bruckhaus Deringer, *A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment* (UNEPFI, 2005); Benjamin J. Richardson, "Do the Fiduciary Duties of Pension Funds Hinder Socially Responsible Investment?" *Banking and Finance Law Review* 22(2) (2007): 145; William Martin, "Socially Responsible Investing: Is Your Fiduciary Duty at Risk?" *Journal of Business Ethics* 90 (2009): 549.

2 Bryan A. Garner, *Black's Law Dictionary* 9th ed. (West, 2009).

3 *See generally* Robert Flannigan, "The Boundaries of Fiduciary Accountability" *Canadian Bar Review* 83 (2004): 35; J.C. Shepherd, "Towards a Unified Concept of Fiduciary Relationships" *Law Quarterly Review* 97 (1981): 51.

4 Johann Klaassen and George Gay, "Fiduciary Duty and Socially Responsible Investing" *Philosophy in the Contemporary World* 10(1) (2003): 49.

and beneficiaries. This relationship provokes several important legal and practical questions regarding SRI, which will be addressed in this article:

- Firstly, while it is widely agreed that trustees must act in the "best interests" of beneficiaries, how are those interests to be deciphered and can beneficiaries instruct trustees on how they should act?
- Secondly, because a financial institution such as a pension fund typically has many beneficiaries, may a trustee act when there is an absence of unanimity among them regarding the desirability of SRI?
- Thirdly, to what extent may evidence of social customs, as expressed for example in international treaties or national legislation, be a proxy for the will of beneficiaries upon which trustees could act? Relatedly, may the interests of third parties such as local communities or other organizations be lawfully taken into consideration by trustees looking for a wider social mandate?
- Fourthly, without a consensus of opinion among beneficiaries or established social customs, to what extent may trustees rely on consultation processes or even having beneficiaries' representatives appointed to governing boards as a basis for engaging in SRI?
- Finally, what potential legal reforms could help strengthen the fiduciary relationship as a basis for financially prudent and democratically-based SRI decisions?

In answering these key questions, it should be stressed that the present ambiguous nature of many fiduciary law principles does not allow one to reach a definitive conclusion in all cases. This article focuses on common law jurisdictions, such as the United States and United Kingdom, where the concept of fiduciary duties originated and is most well established. It is recognized, of course, that some functionally equivalent fiduciary norms exist in civil law systems as a result of financial markets legislation.

The rest of this article is structured as follows. Part II examines the legal relationship between trustees and beneficiaries, including both how trustees' duty to treat different beneficiaries even-handedly and the traditionally passive role of beneficiaries has hindered beneficiaries from exerting a voice for SRI. Having established the basic obstacles posed by fiduciary law, Part III examines some practical challenges to ascertaining the will of beneficiaries as a means of SRI. It examines the impact of a lack of unanimity among beneficiaries, whether fiduciaries can rely on widely-held social customs and consideration of third parties' interests as a proxy for the will of beneficiaries, and the role of statutory reforms mandating consultation with and representation of beneficiaries on the governing boards of trustees. Part IV canvasses some potential legal reforms to strengthen reliance on the will of beneficiaries as a means of SRI. Part V summarizes the article's principal findings.

The article does not canvass the normative rationale for SRI, or the value of law in facilitating SRI. I have previously discussed such issues in my other publications, which do not to be repeated here for the purpose of answering the questions to be tackled by this article.[5]

---

5 *See, e.g.,* Benjamin J. Richardson, "Keeping Ethical Investment Ethical: Regulatory Issues for Investing for Sustainability" *Journal of Business Ethics* 87(4) (2009): 555.

II. THE TRUSTEE-BENEFICIARY LEGAL RELATIONSHIP

A. The Passive Beneficiary

The legal relationship between trustees and beneficiaries is governed by a number of fiduciary duties that serve to ensure that trustees do not act contrary to the interests of the beneficiaries. The idea that there is a *relationship* between the parties has been obscured because traditionally trust law cast beneficiaries into a *passive* role. They are entitled to be informed about the administration of the trust assets, but they traditionally have not enjoyed unqualified rights to be consulted or to instruct trustees on how they should undertake their responsibilities in the absence of legislative provisions. Consequently, the potentiality of basing SRI decisions on the will of the beneficiaries has been legally obscured and hindered.

Rather than treating beneficiaries as self-governing and responsible owners of assets, the trust provides a legal fiction whereby ownership and control become separated, with the owners (beneficiaries) assuming a subservient role while control is vested in trustees to act on their behalf.[6] Trustees, unlike an agent who is subject to control of his or her principal, are not legally obliged to consult with beneficiaries. They only need to act in their "best interests," yet they need not inquire what those best interests are. The beneficiaries' active rights reside mainly in their legal remedies for breaches of trust, but which require time-consuming and expensive litigation to secure.

This legal arrangement, which largely silences beneficiaries, has become the basic framework governing the relationship between investors and financial institutions in many countries. Historically, trusts arose in England primarily to protect family wealth and to provide for the wife and children, who were socially constructed as passive and dependent.[7] Modern investment law transplanted these arrangements for the private trust into a very different context. The transplantation has been successful because of the widespread assumption that investment management is a complex, specialist activity that few lay persons could competently undertake. It would require considerable input of their time and resources, which presumably few would wish to devote. Because of the widespread practice of trustees to delegate fund management to external asset managers, beneficiaries can become even further removed from ultimate decision-making.[8] Thus, the fiduciary relationship has become cemented in the

---

[6] Gary Watt, *Trusts and Equity*, 2d ed. (Oxford University Press, 2006).

[7] On the historical roots of trusts, *see* Alastair Hudson, *Principles of Equity and Trusts* (Cavendish Publishing, 1999).

[8] The external fund managers, for example, may be registered as the owner of shares in the investment portfolio and enjoy exclusive authority to decide how shares are voted. Thus, in the Canadian case of *Verdun v. Toronto Dominion Bank*, [1996] 3 S.C.R. 550, the court disallowed a beneficial shareowner to file ten proposals for inclusion in the annual shareholder's meeting information circular because he was not a registered shareholder. The effect of this case was subsequently nullified by a legislative amendment to allow beneficial owners of shares to advance proposals or requisition meetings, but subject to certain restrictions: *Canada Business Corporations Act*, R.S.C. 1985, s. 137(1).

governance of financial institutions such as pension funds on the basis that investment decision-making is best left to full-time professionals.

Even in financial institutions whose legal architecture draws heavily on other legal norms including contract law, as is the case for mutual funds, the notion that investors are expected to be largely passive has become well-entrenched as a matter of law and business practice. In the retail market, mutual funds operate on the assumption that most investors are not interested in getting involved in investment decisions because they are too busy or unqualified. Investors are considered customers, buying financial products, rather than active owners of investment assets.[9] While investors in mutual funds on paper enjoy some rights—for example under the United States' *Investment Company Act* major decisions, such as a change to the fund's investment strategy, must be submitted to investors for their approval[10]—in practice, the label "mutual" is largely nominal in the governance of mutual funds.[11]

As some financial institutions are constituted as actual corporations, for example banks and life insurance companies, shareholders may be considered among their approximate equivalent "beneficiaries."[12] Shareholders acquire relatively more voice in corporate affairs than analogous beneficiaries under a trust arrangement. They have rights to attend and vote at meetings, and file resolutions, in order to sway corporate policy.[13] However, various factors blunt shareholders' voice, especially when they are small, numerous, and dispersed. Legislation also commonly restricts the form and content of shareholder resolutions, while corporate management retains much control of the proxy voting process. And corporations' boards of directors, whom management in practice tends to appoint, can be ineffectual watchdogs for shareholders.[14] Some commentators, however, hail the rise of powerful institutional investors as majority shareholders as an answer to these problems.[15]

In theory, the most democratically-governed financial institutions are credit unions.[16] Organized as co-operatives, they are "owned by those who use them, not by investors or partners whose interest is to make a profit

---

9 David Llewellyn, "Issues in the Governance of Mutuals in the Financial Sector," Paper commissioned for the Myners enquiry into *Governance of Life Mutuals* (December 4, 2004), 10.

10 Public Law 76-768, 54 Statute 789.

11 John C. Brogle, *The Battle for the Soul of Capitalism* (Yale University Press, 2005), 178-79.

12 Depositors, in the case of banks, and insurance policy-holders, in the case of insurers, are other parties who in certain circumstances might resemble "beneficiaries" in a fiduciary relationship.

13 Richard Nolan, "The Continuing Evolution of Shareholder Governance" *Cambridge Law Journal* 65 (2006): 92.

14 Leslie Eaton, "Corporate Couch Potatoes: The Awful Truth about Boards of Directors" *Barron's* (December 24, 1991), 22.

15 Bernard Black, "Agents Watching Agents: The Promise of Institutional Investor Voice" *UCLA Law Review* 39 (1992): 811, 873-88.

16 *See* Kevin Arness and Barry Howcroft, "Corporate Governance Structures and the Comparative Advantage of Credit Unions" *Corporate Governance: An International Review* 9(1) (2001): 59.

from them."[17] Voting in credit unions is based on a one-member, one-vote (regardless of financial stake), giving each a notionally equal voice in the management of their credit union.[18] Further, the law typically allows any member to submit any issue for discussion of a meeting of credit union members,[19] and they may participate in the management of credit unions (e.g., serving voluntarily on the governing board or advisory committees). But legal restrictions and market barriers have hindered the growth of credit unions, and they remain a relatively minor actor in the financial markets.

In many of these financial institutions policies to promote SRI may be found. These policies are not ordinarily derived from participatory processes involving lay investors. Rather, they are mostly based on the decisions of trustees, investment advisers and other financial experts. Among institutional investors, SRI policies may serve primarily to manage financial risks associated with ESG factors. In the retail market, SRI portfolios may be devised to attract specific types of investors. But even here, the portfolios are effectively sold to investors; their most active role in decision-making is to buy and sell shares in such funds. Yet, many financial trustees and managers clearly do appreciate the value of open, democratic decision-making because they rely on such opportunities for undertaking corporate engagement, filing shareholder resolutions and other actions to exert a voice on behalf of their investors in the companies they hold.[20]

While the purpose of this article is not to canvass the extensive, long-standing debates about the virtues or limitations of democratic decision-making, more participatory governance of financial institutions could provide another basis for SRI. The democratic process is one of the world's most influential and cherished ideals, providing the basis for people reaching collective decisions and effecting change. Democratic decision-making on social and environmental issues has been rationalized from both process and substantive perspectives.[21] The latter reflects arguments that people's participation improves the substantive quality of decision-making. The former is based on claims that it bolsters the public accountability and legitimacy of those decisions. A particular value of participation for SRI is that it may help ground it in a process of ethical deliberation.

The seminal Freshfields report of 2005 on the legal framework for fiduciary finance, prepared by the London law firm on behalf of the United

---

17 Brett Fairbairn, *The Meaning of Rochdale: The Rochdale Pioneers and the Cooperative Principles*, Occasional Paper Series (Centre for the Study of Co-operatives, University of Saskatchewan, 1994).

18 *See, e.g.,* United States' *Federal Credit Union Act* of 1934, Public Law 73-467, 48 Statute 1216; Britain's *Credit Unions Act*, 1979, s. 5(9).

19 Canada's *Cooperative Credit Associations Act*, S.C. 1991, s. 152(1).

20 *See* Tessa Hebb, *No Small Change: Pension Funds and Corporate Engagement* (Cornell University Press, 2008); Adam Kanzer, "The Use of Shareholder Proposals to Address Corporate Human Rights Performance," in *Finance for a Better World: The Shift toward Sustainability*, eds H.C. de Bettignies and F. Lépineux (Palgrave Macmillan, 2009), 71.

21 Nancy Spyke, "Public Participation in Environmental Decision-making at the New Millennium: Structuring New Spheres of Public Influence" *Boston College Environmental Affairs Law Review* 26 (1999): 263, 269-70; Elena Petkova, *et al., Closing the Gap: Information, Participation, and Justice in Decision-making for the Environment* (World Resources Institute, 2002), 66–67.

Nations Environment Programme Finance Initiative (UNEPFI), suggests that beneficiaries' wishes could underpin SRI decisions. It explains:

> [A] decision-maker may integrate ESG considerations into an investment decision to give effect to the views of the beneficiaries in relation to matters beyond financial return. Courts in the UK have recognised that trusts such as charities are entitled to exclude investments that conflict with their values and that the concept of beneficiaries' "best interests" under a general pension trust may extend beyond their financial interests to include their "views on moral and social matters." In a similar way, US law permits investments to be excluded where the beneficiaries so consent.[22]

Despite this optimism, the Freshfields report does not explain how such an arrangement would dovetail with fiduciary law, or how as a practical matter beneficiaries would consent to SRI. While the duty of loyalty—the core fiduciary duty—requires a trustee "to administer the trust solely in the interest of beneficiaries,"[23] it does not necessarily require trustees to consult with or take advice from beneficiaries. Further, even if trustees can lawfully respond to the expressed will of the beneficiaries, the practicality of ascertaining what their will is, especially if they are not unanimous in their opinions, must be resolved.

B. Taking Instructions from Beneficiaries

The idea that trustees should respond to beneficiaries' wishes raises the question of whether beneficiaries can *instruct* trustees in the exercise of their powers. In other words, does the law allow beneficiaries to instruct trustees to adopt a policy for SRI or any other investment approach?

Fiduciary law has recognized that beneficiaries may instruct trustees in some circumstances. The principle was established in 1841 in the English case of *Saunders v Vautier*.[24] It ruled that the sole beneficiary of a trust, if of the requisite legal capacity in terms of age and mental fitness, could request trustees to transfer property held by the trust to him, despite the trust deed envisioning transfer to occur only later in time. In such circumstances, fiduciary law is giving effect to the idea of the beneficiary as the absolute owner, which the trust is restraining. More recently, in the 1997 English case of *Goulding v. James*, it was held that "[t]he principle recognises the rights of beneficiaries, who are *sui juris* and together absolutely entitled to the trust property, to exercise their proprietary rights to overbear and defeat the intention of a testator or settler."[25] Its effect is illustrated in the English case of *Butt v Kelson*,[26] where the trustees, who owned certain shares in the name of the trust, were held by the court to be obliged to vote in a shareholders'

---

22 Freshfields Bruckhaus Deringer, *supra* note 1, 12.

23 Susan Serota and Frederick Brodie, *ERISA Fiduciary Law* (BNA Books, 1995), 25.

24 (1841) 4 Beav. 115, 49 E.R. 282, aff'd Cr. & Ph. 240, 41 E.R. 482.

25 *Goulding v. James* [1997] 2 All E.R. 239, 247.

26 [1952] Ch. 197, [1952] 1 All E.R. 167 (C.A.).

meeting as instructed by the beneficiaries. The principles established by these courts have been recognized in other jurisdictions, such as Australia.[27]

Such judicial precedents, however, do not mean that beneficiaries in *any* trust can issue *any* instructions. Most likely, they could issue instructions if the trust in question is a small, intimate arrangement, such as a private family trust, where all the beneficiaries are adults with full legal capacity, and if they strongly and unanimously take a particular view about a specific investment. In *Cowan v Scargill,* an English case involving a legal challenge to an SRI policy of the trade union trustees of the mineworkers' pension scheme, Robert Megarry V-C gave one example:

> Thus if the only actual or potential beneficiaries of a trust are all adults with very strict views on moral and social matters, condemning all forms of alcohol, tobacco and popular entertainment, as well as armaments, I can well understand that it might not be for the "benefit" of such beneficiaries to know that they are obtaining rather larger financial returns.[28]

But Megarry cautioned that such cases were likely to be few.[29]

There is also other case law that suggests beneficiaries may not instruct trustees.[30] The United States Supreme Court in *Shelton v King*[31] long ago disavowed the idea that beneficiaries could alter the intent of testators or settlers (ie, those who established the initial trust) by issuing instructions to the contrary. In Canada, the Ontario Law Reform Commission observed in its 1984 study of the law of trusts that "[t]o allow beneficiaries to direct the ongoing administration of the trust confuses the role of trustee and beneficiary and is inconsistent with the trust concept. If the creator of a trust wishes the beneficiary to be actively involved in the administration of the trust, such person may always be appointed as trustee."[32]

A further consideration is that in some financial trusts beneficiaries are not the only interest that trustees must take into account. The employer also usually has a stake in an occupational pension fund trust. The employer, especially in a defined benefit plan, has a compelling interest to see that the scheme is competently managed so that it is fully funded to meet its defined liabilities to beneficiaries.[33] While beneficiaries' interests will ordinarily coincide with the employer who sponsors the pension trust, their interests may diverge if beneficiaries seek an SRI policy that could compromise financial returns.

A final key consideration that militates against the view that trustees must act without qualification on beneficiaries' instructions is that they have

---

27 *See CPT Custodian Property Ltd. v. Commissioner of State Revenue; Commissioner of State Revenue v Karingal 2 Holdings Pty Ltd,* [2005] H.C.A. 53.

28 [1985] Ch. 270, 288.

29 *Ibid.*

30 *See*, *e.g.*, *Re Brockbank* [1948] Ch. 206, [1948] 1 All E.R. 287.

31 229 US 90 (1913).

32 Ontario Law Reform Commission, *Report on the Law of Trusts* (Ministry of the Attorney General, 1984), 74.

33 Edward Nugee QC, "The Duties of Pension Scheme Trustees to the Employer" *Trust Law International* 12 (1998): 216, 216-18.

a fiduciary duty to act prudently, which includes taking independent professional advice. To act blindly on beneficiaries' instructions without careful consideration of the wisdom of those instructions could cause legal problems. In the British case of *Martin v. City of Edinburgh District Council*, which involved a challenge to the legality of a policy of the District Council to divest from South African assets, Lord Murray stressed that: "It is their duty to obtain and take into consideration professional advice on whether proposed investment switches are in the interests of the beneficiaries ... ."[34]

In conclusion, this aspect of fiduciary law likely poses a barrier to trustees acting on the will of beneficiaries on the basis of express instructions. As the next section explains, the concomitant fiduciary duty to act impartially poses another barrier.

C. Acting Impartially

A further difficulty with the idea that beneficiaries can instruct trustees arises where the trust has several beneficiaries.[35] What if they are not unanimous in their views on how the trust should be administered or its assets invested? This issue brings to the fore the distinctive fiduciary duty to act *impartially* towards beneficiaries.

Essentially, the duty of impartiality requires a trustee to treat different beneficiaries equitably. In *Cowan v. Scargill,* Robert Megarry V-C referred to "the duty of trustees to exercise their powers in the best interests of the trust, holding the scales impartially between different classes of beneficiaries."[36] In another case disputing the legality of SRI, *Harries and others v. Church Commissioners for England*, Donald Nicholls V-C ruled that: "trustees should not make investment decisions on the basis of preferring one view of whether on moral grounds an investment conflicts with the objects of the charity over another. This is so even when one view is more widely supported than the other."[37] Consequently, if a trustee adopted a policy of SRI to please some beneficiaries, and incurs a financial loss, a breach of this duty to the non-SRI beneficiaries could occur.[38]

The duty of impartiality is subject to modification in the governing trust instrument. As the authoritative United States' *Uniform Trust Code* states, the trustee must treat the beneficiaries equally "in light of the purposes and terms of the trust."[39] Sometimes a trust may permit differential treatment of classes of beneficiaries, such as between present and future retirees of a pension plan. Where there are different classes, but the trust deed is silent on how to reconcile their interests, fiduciary law requires that trustees treat them even-handedly. The American Law Institute's third *Restatement of Law, Trusts* explains: "In what might be called the 'substantive' aspects of impartiality . . . trustees [must] make diligent and good-faith efforts to

34 1988 S.L.T. 329, 332.

35 Graham Moffat, Gerard Bean and John Dewar, *Trusts Law: Texts and Materials,* 4th ed. (Cambridge University Press, 2005), 59.

36 [1985] 1 Ch. 270, 287.

37 [1992] 1 W.L.R. 1241, 1247.

38 Joel C. Dobris, "SRI—Shibboleth or Canard (Socially Responsible Investing, That Is)" *Real Property and Trust Journal* 42 (2008): 755, 761.

39 (2000), s. 803.

identify, respect, and balance the various beneficial interests when carrying out the trustees' fiduciary responsibilities."[40] However, it would be rare, perhaps unheard of, for a trust instrument to specify that trustees could give precedence to the ethical values of one group of beneficiaries over another group to whom they are otherwise equally accountable.

One situation, however, where an SRI policy could be acceptable in the absence of a consensus of opinion is where there are several classes of beneficiaries spanning different generations. American case law recognizes that the duty of impartiality can include an intergenerational equity dimension, behooving trustees to consider the long-term consequences of their investment decisions. In the *Withers v. Teachers' Retirement System* case, the Federal District Court held that the New York City pension fund must be managed to meet future, as well as present, financial obligations. It stated that "the trustees … would have violated their fiduciary obligation had they exhausted the assets of an underfunded actuarially reserved pension system on a single class of beneficiaries (retirees). Their obligation, plainly, was to manage the fund so as to enable it to meet its obligations not only to current retirees, but also to those scheduled to retire in the future."[41] Conceivably, on this basis therefore, trustees could justify SRI that focused on long-term, sustainable investment as a way to ensure that investments could meet the needs of future beneficiaries even if this approach reduced financial returns for current retirees of the pension plan.

In recognition of the potentially divergent opinions among beneficiaries on the appropriateness of SRI, as well as how beneficiaries are assuming greater financial risk under defined contribution pension plans, some governments have enacted legislation that allows beneficiaries to choose the investment portfolio that best matches their ethical and financial preferences. Australia's *Superannuation Legislation Amendment (Choice of Superannuation Funds) Act* of 2004 gives employees the right to choose to some extent the investment portfolio into which their compulsory superannuation contributions are paid. In the United States, the vast majority of private sector defined contribution pension plans also offer a large number of investment options, pursuant to the section 401(k) retirement savings plans established for workers covered by the *Employment Retirement Income Security Act* (ERISA) of 1974.[42] In both jurisdictions, SRI funds may be included among the portfolio options offered to employees.

In conclusion, in the absence of specific legislative provision, fiduciary law does not unambiguously allow beneficiaries in a large financial institution to issue binding instructions to trustees on whether or not they should pursue SRI or how to implement such a policy. Nor can trustees, in the absence of a specific authority under the trust deed or legislative authority, discriminate between different classes of beneficiaries to favour any ethical or other investment preferences of one group over another, except probably to ensure intergenerational fairness to beneficiaries spanning several generations.

---

40 American Law Institute, *Restatement of the Law, Trusts*, 3d ed. (American Law Institute, 2003), s.79(1).

41 447 F. Supp. 1248 (S.D.N.Y. 1978), 1257-58.

42 Public Law 109-280, 88 Statute 829.

While trustees are not ordinarily obliged to heed the views of the beneficiaries, whether or not they are unanimous, they must still act in their best interests. This is a consequence of the fiduciary duty of loyalty. To act loyally not only requires being able to demonstrate that a fiduciary decision serves the "interests" of the beneficiaries; it may also permit trustees to take active steps to ascertain their views, especially where considerable discretionary judgment is involved in the exercise of trust powers.

III. ASCERTAINING THE WILL OF BENEFICIARIES

A. Finding Unanimity among Beneficiaries

In light of the foregoing analysis, a trustee could probably only give effect to any overt desire among beneficiaries for SRI where there is unanimity among them. According to the Freshfields report, "a decision maker who chooses to exclude an investment or category of investments on this basis will need to be able to point to a consensus amongst the beneficiaries in support of the exclusion."[43] But how likely is such a situation?

At first glance, the likelihood of beneficiaries of a particular fund holding similar views on the desirability of SRI would appear to be far-fetched. Disagreements over social values are rife in modern society.[44] Disputes often arise over the environmental consequences of economic developments, which human rights deserve respect, and a host of other ethical issues. There is little doubt that investors have similarly diverse values. Legal commentators sceptical of the legality of SRI have observed that "[w]hat is considered to be 'ethical' in investment terms is inherently subjective, imprecise and continually changing with altered societal perspectives."[45] We live in a postmodern world of ethnic and cultural diversity, in which terms such as "sustainable development" or "corporate social responsibility" can be read differently depending on the context and actors.[46] It is thus not surprising that an advisory committee of the Ontario Teachers' Pension Plan Board spoke of the following challenges to SRI:

> The committee does not recommend any attempt to put definitive screens, either positive or negative, in place. We feel that any attempt to satisfy some particular part of the membership by being definitive about the kinds of investments to be prohibited would simply lead some other part of the membership to feel disadvantaged, or worse, disenfranchised in the decision making process. At worst, screens could lead to litigation on the part of

---

43 Freshfields Bruckhaus Deringer, *supra* note 1, 12.

44 Michael Zimmerman, *Contesting Earth's Future: Radical Ecology and Postmodernity* (University of California Press, 1994).

45 Rosy Thornton, "Ethical Investments: A Case of Disjointed Thinking" *Cambridge Law Journal* 67(2) (2008): 396, 419.

46 *See* John Dryzek, *The Politics of the Earth: Environmental Discourses,* 2nd edn (Oxford University Press, 2005).

> those who feel that the risk accepted or returns realized had negatively affected their pension promise.[47]

Unanimity on ethical issues can be difficult to establish even within groups ostensibly sharing the same fundamental beliefs, such as among church-based investors. In the case of *Harries and others v. Church Commissioners for England*, the court observed that "different minds within the Church of England, applying the highest moral standards, will reach different conclusions" as to the merits of a particular investment.[48] Accordingly, the Church Commissioners in that case were vindicated in their decision not to prefer one ethical view to another "beyond the point at which they would incur a risk of significant financial detriment."[49]

If beneficiaries do not presently share agreement on what is "ethical" or "socially responsible," could they do so through education and dialogue? We might view this as a hopelessly naïve aspiration, given the likelihood of investors' apathy or the risk of relentless squabbling among the few active participants. Yet, theories of ethical and democratic deliberation suggest that social values can evolve among participants through appropriately structured forums for reasoned discussion.[50] Process-oriented legal scholarship and deliberative democratic models emphasize the potential of participatory and transparent decision-making procedures for engineering changes in social values and practices.[51] The SRI community itself has promoted more consultative processes as a means of education and consensus-building, as is evident for example in the Global Reporting Initiative's multi-stakeholder consultation process[52] and the UNEPFI's working groups and round-tables.[53] If ethical deliberation is to be harnessed as a means of developing beneficiaries' will on SRI, legal changes are likely necessary to enhance their participation rights in investment decision-making (an issue discussed later, in section III.D, of this article).

Current academic research that has scrutinized the psychological and socio-economic characteristics of individual social investors and their opinions on various ethical matters, suggests that ethical deliberation must bridge some significant differences of opinion. Some empirical studies suggest that many such investors are unwilling to be altruistic if they would incur a financial loss.[54] Self-styled ethical investors also may hold

---

47 *Report of the Ad Hoc Committee on Socially Responsible Investment* (Ontario Teachers' Pension Plan Board, June 2005), 18.

48 [1992] 1 W.L.R. 1241, 1251.

49 *Ibid.*

50 Carole Pateman, *Participation and Democratic Theory* (Cambridge University Press, 1970); Benjamin Barber, *Strong Democracy: Participatory Policies for a New Age* (University of California Press, 1984).

51 Amy Gutmann and Dennis Thompson "Deliberative Democracy Beyond Process," in *Debating Deliberative Democracy*, eds J. Fishkin and P. Laslett (Blackwell Publishing, 2003), 31; Benjamin J. Richardson and Jona Razzaque, "Public Participation in Environmental Decision-making," in *Environmental Law for Sustainability*, eds B.J. Richardson and S. Wood (Hart Publishing, 2006), 165.

52 *See* <http://www.globalreporting.org>.

53 *See* <http://www.unepfi.org>.

54 Barry Rosen, Dennis Sandler and David Shani, "Social Issues and Socially Responsible Investment Behavior: A Preliminary Empirical Investigation" *Journal of Consumer Affairs*

investments in regular funds, confirming the inclination for financial returns.[55] Conversely, some surveys suggest that most social investors will support SRI causes even if they under-perform the market.[56] Research has also found differences among social investors concerns which SRI issues they care about the most; one study identified military equipment, tobacco and gambling as common concerns,[57] while another concluded that environmental protection and labour relations were more salient.[58] There is also considerable heterogeneity among social investors' beliefs regarding basic terminology and preferred techniques of SRI.[59] Current research thus suggests that social investors have fairly diverse values; presumably, the heterogeneity of values among "regular" investors is even greater.

It should be noted that SRI funds typically do not design their investment policies on the basis of any formal voting among members, and most do not promote their participation in investment decision-making.[60] A few funds however consult informally with investors to help formulate SRI policies. The Ethical Funds Company,[61] from Canada, surveys its members annually to gauge their views on ESG issues. Domini Social Investments, in the United States, has similar arrangements to liaise with its members, and it operates an internet blog to allow clients to voice and exchange opinions.[62]

Another variable that likely influences attainment of unanimity among investors is the type of financial institution they belong to. Most of the research discussed above has canvassed social investors belonging to dedicated SRI funds, where one would expect to find a relatively high convergence of opinion. In the mutual fund sector, investors can shop for an investment product tailored to their own values without the need for agreement with their peers. In an occupational pension fund, whose

---

25 (1991): 221. Jonathan McLachlan and John Gardner, "A Comparison of Socially Responsible and Conventional Investors" *Journal of Business Ethics* 52 (2004): 11, 20-21; Alan Lewis and Paul Webley, "Social and Ethical Investing: Beliefs, Preferences and the Willingness to Sacrifice Financial Return," in *Ethics and Economic Affairs*, eds A. Lewis and K.E. Wärneryd (Routledge, 1994), 171; Jonas Nilsson, "Investment with a Conscience: Examining the Impact of Pro-Social Attitudes and Perceived Financial Performance on Socially Responsible Investment Behavior" *Journal of Business Ethics* 83(2) (2008): 307.

55 Alan Lewis and Craig Mackenzie, "Morals, Money, Ethical Investing and Economic Psychology" *Human Relations* 53(2) (2000): 179.

56 Geoffrey Williams, "Some Determinants of the Socially Responsible Investment Decision: A Cross-Country Study" *Journal of Behavioral Finance* 8(1) (2007): 43; Diana J. Beal, Michelle Goyen and Peter Phillips, "Why Do We Invest Ethically?" *Journal of Investing* 14(3) (2005): 66; Paul Webley, *et al., The Economic Psychology of Everyday Life.* (Psychology Press, 2001).

57 Paul Anand and Christopher Cowton, "The Ethical Investor: Exploring Dimensions of Investment Behaviour" *Journal of Economic Psychology* 14(2) (1993): 377.

58 Rosen, Sandler and Shani, *supra* note 54.

59 Joakim Sandberg, *et al.*, "The Heterogeneity of Socially Responsible Investment" *Journal of Business Ethics* 87 (2009): 519.

60 Christopher Cowton, "Playing by the Rules: Ethical Criteria at an Ethical Investment Fund" *Business Ethics* 8(1) (1999): 60, 64.

61 Since 2009 Ethical Funds merged with another Canadian fund, and is now known as Northwest and Ethical Investments: *see* <http://www.northwestethical.com>.

62 Personal communication, Adam Kanzer, Managing Director and General Counsel, Domini Social Investments (November 5, 2007); and *see* <http://blog.kld.com>.

members come from a specific organization or distinct locality, there might be less divergence of opinion among beneficiaries than in a life insurance company whose policy-holders or shareholders are typically drawn from a wide cross-section of society. Disagreement on SRI issues would presumably be greatest in a national fund, such as the Canada Pension Plan, whose beneficiaries would comprise most of the country's adult population.

A further consideration is what exactly are beneficiaries expected to agree on? The simplest choice would be whether to boycott a specific company or country (one historical example is the divestment campaign against South Africa's former apartheid regime). But it would be more difficult to ascertain the will of beneficiaries on a smorgasbord of fluctuating social and environmental issues, such as climate change, labour standards and human rights. There would simply be too many issues to survey, as well as the challenge of integrating beneficiaries' views into a coherent SRI policy. Furthermore, even if beneficiaries could agree that environmental degradation or violation of human rights is ethically problematic to at least some extent, they could still disagree on the extent to which financial returns should be sacrificed to avoid unethical conduct.

Alternatively, ascertaining beneficiaries' views on the general *principles* to guide SRI decisions might be feasible. The aim would be to reach agreement on the norms governing *how* decisions should be made, rather than any tedious case-by-case consideration of the social and environmental ramifications of individual proposed investments. This approach could be undertaken, to illustrate, by requiring that any company proposed for an investment portfolio have an unblemished record of compliance with environmental regulations, be certified under a rigorous performance standard (e.g., the ISO 14000 series)[63] or be a member of a credible SRI stock market index (e.g., one of the Dow Jones Sustainability Indexes[64]). By this approach, therefore, trustees would follow agreed decision-making principles as a framework for taking ESG issues into account.

B. Following Social Customs

The Freshfields report suggests that trustees could also rely on well-established social customs as, in effect, a proxy for the values of the beneficiaries:

> [T]there will be a class of investments that could reasonably be assumed offensive to the average beneficiary such that they could lawfully be excluded from an investment portfolio without all the beneficiaries' express consent. That class of investments will not be fixed and a conservative approach is advisable, but the types of investment that might fall into that class include investments that are linked to clear breaches of widely recognised norms, such as

---

63 The International Organization for Standardization, at <http://www.iso14000-iso14001-environmental-management.com>.

64 *See* <http://www.sustainability-index.com>.

> international conventions on human rights, labour conditions, tackling corruption and environmental protection.[65]

One reason why such social customs could be considered a *proxy* for the value of beneficiaries is, as Gifford explains, that "[g]iven the ubiquity of pension fund membership, especially in the developed world, it can also be argued that the interests of members of funds are broadly consistent with those of the society in which the members live."[66] But whether trustees could rely on such social customs only when it is impractical to ascertain the views of the beneficiaries is unclear from the Freshfields report. Quite possibly, trustees could not base an SRI policy on such social conventions if the views of beneficiaries on such issues had been explicitly conveyed to the contrary.

Interestingly, the successor report by UNEPFI, issued in 2009, retreats somewhat from the Freshfields' position on the salience of social custom. It states:

> [A] pension fund in its Statement of Investment Principles … may amplify its requirements for monitoring and assessment of ESG considerations. This may be achieved by using examples of a few international law treaties or conventions and/or voluntary guidelines or principles *which the investment industry accepts widely as relevant and having a material effect on investment value*. The pension fund might indicate that it expects its asset manager to have regard to compliance.[67]

In other words, UNEPFI has more explicitly linked any reliance on social customs to their financial materiality. Thus, even if a social custom reflects a very widely-held value, this latest report suggests it would still need to have financial significance to the investment portfolio before trustees could take it into account. However, other legal commentators make no mention of a financial salience criterion. Scott explains that trustees "may decline to invest in, or to retain, the securities of corporations whose activities, or some of them, *are contrary to fundamental and generally accepted ethical principles*. They may consider such matters as pollution, race discrimination, fair employment and consumer responsibility."[68]

There are numerous international treaties governing issues of interest to social investors, including environmental protection (at least 500 such treaties and other international instruments[69]), human rights (some 300

---

65 Freshfields Bruckhaus Deringer, *supra* note 1, 96.

66 James Gifford, "Measuring the Social, Environmental and Ethical Performance of Pension Funds" *Journal of Australian Political Economy* 53 (2004): 139, 141.

67 United Nations Environment Programme Finance Initiative (UNEPFI), *Fiduciary Responsibility: Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment* (Asset Management Working Group, UNEPFI, 2009), 26 (my emphasis).

68 Austin W. Scott, *The Law of Trusts,* 3rd edn (Little Brown and Company, 1967 and Supplement 1979), s. 227.17 (my emphasis).

69 The Ecolex project sponsored by several United Nations identifies at least 520 international environmental treaties: <http://www.ecolex.org>.

agreements, declarations and other instruments[70]), and labour standards (nearly 200 treaties[71]). Some are widely ratified and thus putatively reflect a near-consensus of international opinion. They include the 1992 *Convention on Biological Diversity*[72] (adopted by approximately 190 states) and the 1966 *Convention on the Elimination of All Forms of Racial Discrimination*[73] (adopted by nearly 175 states).[74] Some institutional investors rely on such treaties as a reference point for consideration of ESG issues. The Ethical Investment Research Service (EIRIS) in Britain offers a service for fund managers called "Convention Watch," whereby it scrutinizes companies for their compliance with various international treaties and other global instruments.[75] The Guardians of the New Zealand Superannuation Fund, whose governing legislation requires that their investments "avoid prejudice to New Zealand's reputation as a responsible member of the world community,"[76] relies on compliance with the *UN Global Compact* and international treaties to assess corporations.[77]

However, relying on international treaties or other evidence of social mores as a basis for legitimating fiduciary finance faces difficulties. First, while certain social norms, as embodied in international treaties or national laws, reflect to a large extent democratically-determined decisions, invariably not everyone agrees with them. For instance, regarding international environmental agreements, many people in developing countries, preoccupied by poverty alleviation and social justice, are less supportive of nature conservation when it hinders urgently needed economic development.[78] Second, many environmental standards and human rights are too vague to provide concrete guidance in specific cases. To illustrate, the *Convention on Biological Diversity* states in article 10 that: "Each Contracting Party shall, as far as possible and as appropriate: … encourage cooperation between its governmental authorities and its private sector in developing methods for sustainable use of biological resources." This and other clauses in this treaty may be interpreted in various ways to justify divergent actions. The drawback, therefore, with such open-ended standards is that fund managers or trustees may make decisions contrary to the expectations of many others.

If institutional investors can only act on the basis of established social norms, a further quandary is that they might no longer be at the vanguard of social change. Historically, the very purpose of SRI was to be a means by

---

70 Consider the list complied by the UN High Commissioner for Human Rights: <http://www2.ohchr.org/english/law>.

71 International Labour Organization, ILOLEX: Database of International Labour Standards: <http://www.ilo.org/ilolex/english/convdisp1.htm>.

72 I.L.M. 31 (1992): 818.

73 I.L.M. 5 (1966): 352

74 *See* Daniel Bodansky, Jutta Brunée and Ellen Hey, eds, *Oxford Handbook of International Environmental Law* (Oxford University Press, 2007); Michael Haas, *International Human Rights: A Comprehensive Introduction* (Routledge, 2008).

75 EIRIS, "Convention Watch Briefing Paper" (EIRIS, undated).

76 *New Zealand Superannuation and Retirement Income Act,* 2001, s. 58(2)(c).

77 Guardians of New Zealand Superannuation Fund (NZSF), *Responsible Investment Policy, Standards and Procedures* (NZSF, June 27, 2007), 5.

78 Patrick Peritore, *Third World Environmentalism: Case Studies from the Global South* (University Press of Florida, 1999).

which ethical investors would act when governments had failed to do so; among examples, the ethical investment campaign of the Quakers against the slave trade and, later, the churches' divestment crusade against South Africa's apartheid regime, were motivated by the desire to overcome the failure of governments to legislate reforms. In the context of fiduciary finance law, such a strategy is less likely today.

C. Third Party Stakeholders

Closely related to the previous discussion of whether the fiduciary relationship can be informed by established social customs, as a proxy for the will of beneficiaries, we must ask whether trustees could also take into account the views of third party stakeholders, as both an indicator of such social mores and as a means of fulfilling a socially responsible agenda. It is a controversial issue, and one seemingly directly at odds with the essence of a fiduciary relationship tethered to a trustee's exclusive loyalty to the beneficiaries. The principal objection to any dilution of this exclusivity is that it would unduly complicate decision-making and foster agency problems. Marcoux explains that "the nature of the fiduciary relationship is such that it is impossible for one to act as a fiduciary for multiple parties where the interests of those parties are (or are likely to be) in conflict."[79] If fiduciaries must also serve other constituencies, their decisions might degenerate into an arbitrary balancing of competing interests or could cloak self-interested choices by trustees emboldened by greater discretionary power.

Yet, even if this objection is plausible, already the fiduciary duty to act in the best interest of beneficiaries has been interpreted by courts and regulators in some jurisdictions as at least not prohibiting decisions that provide collateral benefits to others (e.g., to a local community or another organization). In the United States, the *Employee Retirement Income Security Act* (ERISA) of 1974 has been interpreted by the federal Department of Labor as "not preclud[ing] consideration of collateral benefits, such as those offered by a 'socially-responsible' fund."[80] In *Donovan* v. *Walton*, the court observed that "ERISA … simply does not prohibit a party other than a plan's participants and beneficiaries from benefiting in some measure from a prudent transaction with the plan."[81] A further consideration is that conceivably the "best interests" of beneficiaries could include explicitly taking the welfare of third parties into account if the beneficiaries are driven by philanthropic concerns. The Canadian case of *R. v. Irving*[82] has affirmed that the "best interests" standard should be interpreted liberally and not necessarily be confined to financial benefits.

In the related area of corporate governance, courts and legislators have gradually broadened directors' fiduciary responsibilities and powers to

---

79 Alexei Marcoux, "A Fiduciary Argument Against Stakeholder Theory" *Journal of Business Ethics* 13(1) (2005): 1, 4.

80 R.J. Doyle, Pension and Welfare Benefits Administration, Office of Regulations and Interpretations, Advisory Opinion (May 28, 1998).

81 *Donovan* v. *Walton,* 609 F. Supp. 1221 (D.C. Fla. 1985), 1245.

82 (1975) 11 O.R. (2d) 442 (the case involved variation of a trust, ostensibly contrary to the original intention of the settlor).

permit some consideration of outside interests, such as those of employees, consumers, creditors, and other parties with whom the corporation has contractual or other relationships that may affect its financial success. This represents a departure from the traditional legal doctrine that directors' owe fiduciary duties exclusively to the company or the firm and its shareholders. The trend began when courts approved of directors making charitable donations with company assets.[83] In 2004 the Supreme Court of Canada ruled in *Peoples Department Stores v Wise* that directors may consider factors beyond the short-term maximization of the value of the company, such as "consumers, governments and the environment."[84] Likewise, the United Kingdom's *Companies Act* of 2006, which Williams and Conley salute as "close to a stakeholder model of director's duties,"[85] permits directors to consider community and environmental impacts among issues relevant to promoting their company's financial success.[86] Another approach, found in the United States, is the so-called "constituency statute," authorizing directors to consider the effects of their decisions on specific categories of stakeholders, such as employees, suppliers, customers, and local communities.[87] A limitation of all of these models is that third parties cannot normally *oblige* company directors to take their interests into account. There is a material difference between being able to consider the welfare of other parties and *owing a duty* to them. Thus, outside stakeholders without legal remedies risk having their interests ignored.

While we should be careful about analogizing how fiduciary duties apply in corporate governance to all financial institutions, given that corporations are generally embedded in a much wider and more complex array of legal and business relationships, the analogy is pertinent for some reasons. Firstly, some financiers have a corporate personality, such as banks and life insurers, and are immersed in similarly complex social relationships that may engender fiduciary-like responsibilities. Secondly, the SRI movement is helping to illuminate the connections between finance and its social and environmental effects, thus creating legal and financial risks for investors who are perceived to profit from environmental degradation or human rights violations. Waygood has documented very well how nongovernmental organizations such as the World Wide Fund for Nature are trying to change the environmental behaviour of companies by targeting

---

[83] Edward Adams and Karl Knutsen, "A Charitable Corporate Giving Justification for the Socially Responsible Investment of Pension Funds: A Populist Argument for the Public Use of Private Wealth" *Iowa Law Review* 80 (1995): 211. For example *A.P. Smith Manufacturing Co. v. Barlow*, 13 N.J. 145, 98 A. 2d. 581; 346 U.S. 861 (1953); *Union Pacific Railroad Co. v. Trustees,* 8 Utah 2d. 101, 329 P. 2d. 398 (1958).

[84] [2004] 3 S.C.R. 461, 2004 S.C.C. 68, para. 42. Also, Catherine Francis, "*Peoples Department Stores Inc. v. Wise:* The Expanded Scope of Directors' and Officers' Fiduciary Duties and Duties of Care" *Canadian Business Law Journal* 41 (2005): 175.

[85] Cynthia A. Williams and John M. Conley, "Triumph or Tragedy: The Curious Path of Corporate Disclosure Reform in the UK" *William and Mary Environmental Law and Policy Review* 31(2) (2007): 317, 354.

[86] Section 172(1).

[87] Stephen Bainbridge, "Interpreting Nonshareholder Constituency Statutes" *Pepperdine Law Review* 19 (1992): 991.

their financial sponsors.[88] Some experts thus suggest there is an emerging fiduciary duty to consider the financial risks associated with handling of environmental issues such as climate change[89] and treatment of human rights. Williams and Conley argue that "risks to companies' reputations and therefore to the value of their brands from highly-publicized problems with stakeholders or human rights issues may" give rise to fiduciary duties to "consider the rights and interests of stakeholder groups."[90] Thirdly, occasionally legislation may impose specific obligations on financiers to consider the interests of third parties. One example is the United States' *Community Reinvestment Act* of 1977,[91] which obliges commercial banks to improve access to affordable banking services to the local communities in which they are chartered.[92]

In conclusion, the fiduciary relationship is increasingly viewed by some regulators and investors as not simply a bilateral relationship between financial trustees and beneficiaries. Rather, it may also encompass third parties potentially affected by their investment decisions. While we have yet to reach a situation where third parties have legally enforceable claims, at least trustees are beginning to have a legal mandate to take their interests into account.

D. Consultation with and Representation of Beneficiaries

Consultation with beneficiaries or even appointment of their representatives to the governing boards of investment institutions provide means by which the will of beneficiaries can be expressed. This approach can be rationalized from an SRI perspective on the basis that if we expect financial entities to be more accountable for the social and environmental consequences of their investments, then the ultimate owners of capital should have more voice in the determination of those investments. By providing for representation of beneficiaries in fund governance, it might no longer be necessary for trustees to find a consensus of opinion among beneficiaries in order to take ESG issues into account. Rather, through beneficiaries' representatives such issues would be considered and ultimately acted upon by the governing board. In an ordinary trust, the trustees cannot make decisions unless they are unanimous, but legislation commonly allows trustees to make decisions by a majority vote.

Being a representative of beneficiaries however does not under fiduciary law allow a trustee to consider him or herself an *agent* of the

---

88 Steve Waygood, *Capital Market Campaigning: The Impact of NGOs on Companies, Shareholder Value and Reputational Risk* (Risk Books, 2006).

89 "Climate Change a 'Fiduciary Duty' for Trustees – Mercer," *Environmental Finance,* online edition (September 2005); Mercer Investment Consulting, *A Climate for Change - A Trustee's Guide to Understanding and Addressing Climate Risk* (Mercer Investment Consulting, 2005).

90 Cynthia A. Williams and John M. Conley, "Corporate Social Responsibility in the International Context: Is there an Emerging Fiduciary Duty to Consider Human Rights?" *University of Cincinnati Law Review* 74(Fall) (2005): 75, 76-77.

91 Public Law 95-128, §§ 801-06, 91 Statute 1147.

92 James Campen, "Banks, Communities and Public Policy," *Transforming the U.S. Financial System: Equity and Efficiency for the 21st Century*, eds G.A. Dymski, *et al.* (M.E. Sharpe 1993), 221.

beneficiaries, acting only according to instructions given. In *Cowan v Scargill*, the court held that trustees who could be considered as having been appointed in a representative capacity would violate their duties if, instead of applying their minds independently to a fiduciary issue which was before them, just followed a policy decision of the body (in this case the National Union of Mineworkers) which they might be regarded as representing.[93] Robert Megarry V-C rejected the suggestion that the defendants' impugned investment policy could be justified because it was consistent with the majority views of a representative body of beneficiaries as expressed by their investment policy adopted by their union at their annual conference.

Several jurisdictions have legislated for employees' representation on pension fund boards. It has proven controversial in some cases, leading to claims that investment decision-making has become more "politicized," creating conflict rather than consensus.[94] In addition, Canadian researchers have observed that "[l]abor trustees … face many challenges acquiring the skills, knowledge and networks to assist them in becoming active and integrated participants on the pension board."[95] Among the statutory reforms, in Britain, amendments to the *Pensions Act* in 2004 prescribed that "at least one-third" of the trustees must be "member-nominated,"[96] and the government may enact regulations to raise this number to one-half member-nominated trustees.[97] Australia's *Superannuation Industry (Supervision) (SIS) Act* of 1993 mandates 50 percent member representation on trustee boards of funds that have at least five members.[98] Canadian governments have also established some mechanisms for member participation in pension plan governance. Quebec law requires an elected pension committee, separate from the employer-administered plan unit, with some decision-making authority.[99] Another legislative model is the joint, union-employer trusteeship of public sector pension schemes, such as provided for by British Columbia's *Public Sector Pension Plan Act*.[100] Among other jurisdictions, South African law mandates at least 50 percent member representation on trustee boards,[101] while Brazilian legislation stipulates mandatory employee representatives to make up between one-third and one-half of the governing organs of public and private pension funds.[102] Representation of employees in the governing boards of pension funds also

---

93 [1985] Ch. 270, 293.

94 David Hess, "Protecting and Politicizing Public Pension Fund Assets: Empirical Evidence on the Effects of Governance Structures and Practices" *University of California-Davis Law Review* 39(1) (2005): 187, 199; Saunders Taylor, *Public Employee Retirement Systems: The Structure and Politics of Teacher Pensions* (Cornell University Press, 1986).

95 Johanna Weststar and Anil Verma, "What Makes for Effective Labor Representation on Pension Boards?" *Labor Studies Journal* 32(4) (2007): 382.

96 Section 241(1)(a).

97 Section 243(1).

98 Sections 52, 58, 89, 101, 107.

99 *Supplemental Pension Plans Act*, S.Q. 2001, s. 147.

100 S.B.C. 1999.

101 *Pension Funds Act*, 1956, as amended, s. 7A.

102 *Lei Complementar* No. 109 (2001), Capítulo III, art. 31; *Lei Complementar* No. 108 (2001), Capítulo III, art. 9.

occurs in several continental European countries, including Denmark, Italy, Switzerland and the Netherlands.[103]

Financial trustees may also be subjected to a statutory duty to consult with their beneficiaries when formulating investment policies.[104] In one of the few legislative mandates for SRI, Ontario's former *South African Trust Investments Act* of 1988 provided that, in the case of pension funds with at least 100 beneficiaries, the trustees could refuse to acquire or dispose of a South African investment once they had made inquiries and had reasonable grounds for believing that most beneficiaries would consent and that they held a majority of the beneficial interests in the pension fund's assets. In other trust law contexts legislation has also sometimes intervened to require consultation with beneficiaries. In Britain, the *Trusts of Land and Appointment of Trustees Act* of 1996 requires trustees to consult with beneficiaries when exercising certain specified functions.[105] The concept of a "duty to consult" in fiduciary law has been most strongly developed by Canadian courts in the context of the government's obligations to Aboriginal peoples. Courts have held that such a duty arises when the government (federal or provincial) contemplates conduct that might adversely affect Aboriginal rights.[106] A duty to consult, however, is not tantamount to a duty to accommodate; trustees being required to ascertain the views of beneficiaries do not necessarily have to give effect to their wishes.

A related legislative trend in some jurisdictions is strengthening the informational rights of beneficiaries, by requiring trustees to disclose their investment policies including with regard to SRI. Such reforms have been introduced in the United Kingdom and several other European states, and Australia, obliging occupational pension funds to disclose their SRI policies, if any.[107] The regulations however do not *oblige* these funds to follow SRI. Another reform, adopted in Canada and the United States, requires mutual funds to disclose their shareholding proxy voting policies and voting records.[108] Its purpose includes discouraging fund managers from passively colluding with corporate management, and through a more active proxy process to improve the quality of corporate governance. Voluntary standards, such as the Eurosif Transparency Guidelines,[109] also emphasize information disclosure and communication. Research on implementation of some of these standards however reveals shortcomings, with mandated

---

103 Fiona Stewart and Juan Yermo, "Pension Fund Governance: Challenges and Potential Solutions," OECD Working Papers on Insurance and Private Pensions No. 18 (OECD, 2008).

104 Watt, *supra* note 6, 437.

105 Section 11.

106 *See* Sonia Lawrence and Patrick Macklem, "From Consultation to Reconciliation: Aboriginal Rights and the Crown's Duty to Consult" *Canadian Bar Review* 79 (2000): 252.

107 *E.g.,* UK's *Occupational Pension Schemes (Investment) Regulations,* 2005: cl. 2(3)(b)(vi)-(3)(c); Australia's *Corporations Act*, 2001 (Cth)*,* s. 1013D(1)(l); France's *Projet de loi sur l'épargne salariale* (7 February, 2001). No 2001-152, arts 21, 23.

108 Securities Exchange Commission (SEC), 'Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies' (SEC, January 31, 2003); Canadian Securities Administrators (CSA), *National Instrument 81-106 Investment Fund Continuous Disclosure and Companion Policy 81-106 CP* (CSA, 2005).

109 *See* <http://www.eurosif.org/publications/european_sri_transparency_code>.

disclosures sometimes leading to vague, boilerplate statements that do not illuminate the methodology behind SRI decisions or the quality of their implementation.[110]

These legislative reforms, largely confined to the pension fund sector, have been driven by several developments which provide insights into how giving more voice and information to beneficiaries can be rationalized. Because occupational pension plans are often an indelible part of the employment relationship, there has been pressure to extend participation of employees in workplace decisions to their pension funds.[111] A related contention is that enhancing workers' participation in pension fund governance helps to extend their influence to corporate governance and economic development for their benefit.[112] The shift from defined-benefit (DB) to defined-contribution (DC) pension plans has further strengthened the case for giving members more voice.[113] As beneficiaries are exposed to greater financial risks to their retirement plans, the argument grows that they should have more say in making investment decisions.[114] OECD guidelines on occupational pension regulation recommend that beneficiaries in DC plans be allowed to choose their investment options.[115] More voice to beneficiaries is particularly important when beneficiaries have limited ability to transfer their savings elsewhere. Unlike mutual fund investors, members of occupational pension plans often cannot readily withdraw their contributions unless they change jobs and join a different pension plan.

But does democratizing investment decision-making in such manner make SRI more likely? Are beneficiaries more likely to demand socially responsible decisions if they have an opportunity to be heard? The current anecdotal evidence suggests a modest correlation. More democratically-governed funds sometimes appear to be at the forefront of SRI. A pioneering research program on United States public pension plans and urban revitalization coordinated by Harvard and Oxford universities has documented a wealth of case studies of investors partnering with community development associations and local financial intermediaries to promote urban renewal and community economic development.[116] Tessa

---

110 Chris Gribben and Adam Faruk, *Will UK Pension Funds Become More Responsible? A Survey of Trustees - 2004* (UK Social Investment Forum, 2004); Fair Pensions, *UK Pension Scheme Transparency on Social, Environmental and Ethical Issues* Fair Pensions, (2006); Benjamin J. Richardson, *Socially Responsible Investment Law: Regulating the Unseen Polluters* (Oxford University Press, 2008), 303-31.

111 *See* Jeffrey Gates, *The Ownership Solution: Toward a Shared Capitalism for the 21st Century* (Addison-Wesley Publishing, 1998); Arhcon Fung, Tessa Hebb and Joel Rogers, eds, *Working Capital: The Power of Labor's Pensions* (Cornell University Press, 2001).

112 Peter Drucker, *Unseen Revolution: How Pension Fund Socialism Came to America* (Heinemann, 1976).

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

114 Robert A.G. Monks and Neil Minow, *Power and Accountability* (Harper Collins, 1991), 223.

115 OECD, *Recommendation on Core Principles of Occupational Pension Regulation* (OECD, July 21, 2004), 5.16, 5.24 and 5.27.

116 *See* <http://urban.ouce.ox.ac.uk/research.php>. *See*, in particular, Gordon Clark, Tessa Hebb and Lisa Hagerman, *U.S. Public Sector Pension Funds and Urban Revitalization: An Overview of Policy and Programs* (School of Geography and the Environment, University of Oxford, 2004).

Hebb's landmark study on pension fund engagement in North America found that public sector funds such as CalPERS were more committed than private pension funds to engage with companies on SRI issues, partly because of the greater presence of member-nominated trustees and trade union-influence in pension plan governance.[117] An earlier Canadian study on the impact of union representation in pension funds found "some evidence that union involvement is facilitative of social investment."[118]

On the other hand, some empirical research suggests that the views of pension fund members in practice tend to carry little weight in investment decisions.[119] A 2005 survey of British occupational pension fund trustees revealed that 53 percent of respondents attached "no significance" and only 13 percent attached "great significance" to the views of their members when considering ESG issues in their investment policies.[120] Even among dedicated SRI funds in the mutual fund industry, while a few may informally survey their members periodically for their views on SRI, most funds generally do not provide forums for active dialogue among investors nor encourage their participation in investment policy-making.[121]

Such anecdotal evidence perhaps points to the limitations of current participatory mechanisms in fund governance. It is preferable to give beneficiaries more formal opportunities to be heard than to rely on informal and less transparent and accountable consultative arrangements. Strengthening their voice in fund governance, by legal rights either to be consulted or represented on boards, provides a concrete way to convey their views and to enable trustees to make investment decisions legitimated by the imprimatur of the democratic process. It could even provide a framework for ethical deliberation to guide SRI decisions. Such an approach heralds a significant evolution in the nature of the fiduciary relationship, away from the traditionally subservient role of beneficiaries.

IV. REFORMING FIDUCIARY FINANCE RELATIONSHIPS

The current legal framework governing fiduciary finance relationships is unlikely to remain fixed indefinitely; this article has identified several areas where modest reforms in some jurisdictions are underway already, ranging from improved disclosure of investment policies to discretionary consideration of third parties' interests. It is thus worth concluding this article by canvassing briefly some further legal measures by which fiduciary finance could accommodate better the will of beneficiaries. Ignoring reform is unrealistic given that both the recent global financial crisis and the burgeoning movement for SRI are intensifying pressure for improved social accountability of financial actors. It is becoming increasingly difficult to

---

117 Hebb, *supra* note 20.

118 Jack Quarter, *et al.*, "Special Investment by Union-based Pension Funds and Labour-Sponsored Investment Funds in Canada" *Industrial Relations* 56(1) (2001): 92, 108.

119 Gregory Alexander, "Pensions and Passivity" *Law and Contemporary Problems* 56(1) (1993): 111, 113.

120 Chris Gribben and Matthew Gitsham, *Will UK Pension Funds Become More Responsible: A Survey of Trustees* (UK Social Investment Forum, 2006), 14.

121 Richardson, *supra* note 110, 275.

view fiduciary finance as just value-neutral investment transactions devoid of any ethical, social or environmental ramifications. The following suggestions are not tailored to any specific type of financial institution, which of course would be essential for any credible legal reform, but are intended as generic ideas to stimulate debate.

One option, being perhaps the most politically feasible, is to extend current initiatives, including by mandating appointment of more beneficiaries to advisory committees, nominating beneficiaries to the governing boards and requiring trustees to consult periodically with beneficiaries, such as through surveys or referendums, when proposing major investment policy decisions. These procedural reforms would not per se alter the underlying fiduciary duties, but would strengthen the fiduciary relationship by enabling trustees to be better informed about what the "best interests" of beneficiaries are. To have teeth, a duty to consult should include a collateral duty on trustees *to consider* or *take into account* the views of consulted beneficiaries. This would not necessarily oblige trustees to follow the opinions of beneficiaries, but would at least oblige trustees to consider carefully their views and to be able justify their final decisions.

The law could also mandate trustees to act, albeit within the purpose of the trust, without express unanimity among beneficiaries. It could authorize such decisions so long as they are satisfied that their decisions do not unduly or materially disadvantage one class of beneficiaries. Beneficiaries might even be able to at least agree on the broad *principles* governing an SRI policy, such as to favour investing in companies which belong to an approved SRI market index or which are certified under a credible sustainability performance standard. Otherwise, legislation could allow trustees to act on the wishes of beneficiaries where a specified substantial majority agreed, such as a large, three-quarters majority.

Such a reform would need safeguards for minority beneficiaries. This would be crucial so as to uphold the fundamental duty of trusteeship to treat beneficiaries even-handedly. Trustees could be required to demonstrate that any such SRI policy still fulfills the duty of care, such as by demonstrating the policy's financial prudence. Yet, because the latter safeguard could thus limit SRI decisions to those viewed as "financially material" to investment performance, it would not greatly improve the mandate for advancing SRI than available now. Hence, other mechanisms to safeguard the interests of a minority might be necessary. One option is to oblige trustees to offer alternative investment portfolios to different classes of beneficiaries, covering SRI and other investment approaches.

Legislating duties to consult and accommodate would also desirably need to be supplemented by a duty on trustees to inform beneficiaries and themselves about the nature of SRI and its financial and social effects and risks. Under fiduciary law, any beneficiary consent must be given on the basis of disclosure of all relevant information.[122] As previously mentioned, in a number of jurisdictions laws have been enacted requiring financial institutions to disclose their policies on SRI. They could be extended to require disclosure of how such policies are *implemented*, including evaluation

---

122 *Boardman v. Phipps* [1967] 2 A.C. 46, 101.

of their impact and effectiveness in promoting socially responsible outcomes. Although such an approach creates additional compliance costs, informed consent perhaps warrants such a comprehensive approach.

Legislation could go further to oblige trustees to invest ethically and responsibly. Financial institutions would by this approach start to resemble mission-based investors, which have an ethical charter in their trust deed. Similar suggestions have been made to return corporations to their origins in the nineteenth century as civic-minded institutions operating under public charters.[123] Contemporary reform is not unprecedented. In 2007 Oregon amended its *Business Corporations Act* to permit expressly an Oregon company's articles of incorporation to include a provision "authorizing or directing the corporation to conduct the business of the corporation in a manner which is environmentally and socially responsible."[124] While the effect of the Oregon legislation has yet to be ascertained, the law does not oblige companies to have such an objective—rather, they may choose to do so. More relevantly, in the financial sector, the managers of the national pension plans of Norway, Sweden and New Zealand are legislatively obliged to follow ethical and responsible investment policies.[125]

Of course, such imposed SRI legislative charters are seemingly at odds with the idea of a bottom-up approach to SRI derived from the unadulterated free will of beneficiaries. The principal justification for such an approach, as I have elaborated elsewhere,[126] is that the freedom to invest includes the responsibility to avoid sponsoring and profiting from environmentally harmful and socially unjust development. Hawley and Williams have also argued persuasively how it is in the self-interest of "universal" investors to be mindful of such considerations, because as economy-wide investors, they should have no interest in abetting behaviour by any one company that yields a short-term financial advantage while undermining the health of the economic systems in which the firms in which they invest are embedded.[127] Thus, SRI-imposed mandates may be reconciled with the will of beneficiaries as paternalistic regulation to ensure beneficiaries do not advocate investments which in the long-term could be inimical to their own self-interest. Such SRI mandates would also invariably be written broadly, as current examples in Scandinavia and New Zealand are, to offer sufficient latitude for deliberation and choice by beneficiaries.

Alternatively or in addition to this approach, the law could provide new means by which trustees may accommodate social customs or third party interests. One option is to establish an ethics advisory council to provide advice or direction on social expectations for SRI. Trustees following its advice could be deemed to be acting in accordance with fiduciary standards.

---

123 Andrew Fraser, *Reinventing Aristocracy: The Constitutional Reformation of Corporate Governance* (Ashgate, 1998).

124 Oregon Revised Statutes, 2007 § 60.047(2)(e).

125 Sweden's *Lag om allmänna pensionsfonder (AP - Fonder), Svensk författningssamling* (2000): 192; Norway's ethical investment mandate was issued on December 22 2005 pursuant to *Regulation on the Management of the Government Pension Fund,* 2004; and New Zealand's *Superannuation and Retirement Income Act* 2001, ss. 58(2)(c) and 61(d).

126 Richardson, *supra* note 5.

127 James P. Hawley and Andrew T. Williams *The Rise of Fiduciary Capitalism* (University of Pennsylvania Press, 2000).

The government could appoint representatives from key constituencies to the council to ensure it is broadly representative of societal values. This idea is not as far-fetched as it might seem, as ethics councils have already been established for this purpose in relation to national pension plans in Norway and Sweden. The ethics advice of these Scandinavian councils is often based on well established international law. UNEPFI's survey in 2007 of the Swedish and Norwegian funds, among other examples of public sector pension plans, found "a range of some of the most advanced and creative approaches to responsible investment."[128] Such an approach has yet to be adopted for private sector funds, and it would certainly be controversial. They might tolerate an ethics panel with a more restrained mandate, such as responsible for setting general guidance and voluntary standards. Already, institutions such as the United Nations Principles for Responsible Investment and the UNEPFI to some extent play this role.

Ultimately, even with such reforms, trying to regularize SRI under fiduciary law by appealing to the will of beneficiaries or social customs is challenging. It is unlikely that there would be unanimity among beneficiaries in a large financial institution regarding the desirability of SRI; at most, they might agree to some procedural standards or general principles to govern SRI decision-making. This approach, however, could generate new problems if trustees gain too much discretionary power to determine what is "socially responsible." Enhancing opportunities for more democratic deliberation among beneficiaries might also fail to engender change. The voices for ethical change could become drowned in arenas where typically money talks the loudest. Many beneficiaries might wish to shun SRI altogether if they perceive it as too financially risky. Thus, more "democratic" decision-making might degenerate into an unsavoury battle of competing interests, rather than a harmonious dialogue towards an ethically-guided consensus. The seemingly easy solution would be to impose even more rigid SRI mandates by law, but that could be politically difficult and undermine the democratic basis to SRI.

V. CONCLUSIONS

The above considerations are hardly decisive reasons to shun reform or abandon further discussion of this pressing topic. If we accept that the financial sector must share responsibility to promote socially just and environmentally sustainable development, as I have previously argued, it is imperative to promote public debate about how the fiduciary relationship can be restructured to promote SRI. While the pioneering Freshfields report remarked that trustees can act on the will of beneficiaries, it overlooked various legal and practical difficulties.

This article has sought to contribute to knowledge of how fiduciary law affects SRI by focusing on the salience of the will of beneficiaries, and

---

[128] UNEPFI Asset Management Working Group and UK Social Investment Forum, *Responsible Investment in Focus: How Leading Public Pension Funds are Meeting the Challenge* (UNEPFI, 2007), 7.

analysing the obstacles and opportunities to having trustees act on their will. Despite lingering ambiguities in fiduciary law, this article has found:

- Trustees are generally not obliged to consult with or take instructions from beneficiaries, except pursuant to specific legislation. It is regulation rather than fiduciary law that mostly enables the voice of beneficiaries to be heard. Only rarely, such as in a small, private trust with few beneficiaries, might they exert their views. Otherwise, trustees are free to interpret what is their "best interests" based on the terms of the governing trust deed.
- In practice, unanimity among beneficiaries in a large financial institution on social, environmental and other ethical issues is unlikely to occur. While they might rarely agree on some general principles or procedures to govern SRI, and perhaps even concur to shun exceedingly controversial actions, such as investment in a country associated with genocide, on most SRI issues beneficiaries will have widely different opinions.
- Trustees must ordinarily treat beneficiaries even-handedly, and thus cannot easily respond to the will of beneficiaries if there is no unanimity among them. Differential treatment is only possible if the trust deed or governing legislation allow. The situation of different classes of beneficiaries spanning several generations (e.g., present and future retirees of a pension fund) may allow trustees to invest responsibly for the long-term to protect a specific class.
- Social customs and third parties may be considered by trustees, but primarily only as an adjunct means of fulfilling the best interests of beneficiaries. Such considerations might include avoiding investing in socially controversial activities posing financial risks.
- Statutory mechanisms that provide for consultation with or appointment of beneficiaries as trustees do not alter the underlying fiduciary rules. Trustees must still treat all beneficiaries impartially, and they do not become their agents. These statutory mechanisms are valuable primarily to help trustees be better informed of what the interests of beneficiaries are, especially where trustees hold significant discretionary powers over beneficiaries' assets.
- Finally, legal reforms are starting to tinker with the fiduciary relationship, and some options to strengthen the voice of beneficiaries in fund governance exist. The principal lesson is that there is a potential tension between, on the one hand, legislatively imposing SRI mandates and, on the other, giving beneficiaries more independence to determine their own investment goals.

It remains worthwhile to reform the fiduciary relationship, because the voice of beneficiaries in modern financial institutions should be heard. If SRI becomes simply a matter of regulatory prescription or a means for trustees to advance their own social and political ideology, it may lose legitimacy and suffer accordingly.