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(Re-)Interpreting Fiduciary Duty to Justify Socially Responsible Investment for Pension Funds?

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ABSTRACT

Manuscript Type: Conceptual
Research Issue: A critical issue for the future growth of socially responsible investment (SRI) is to what extent institutional investors such as pension funds can be persuaded to engage in it. This paper considers attempts at justifying such engagement stemming from a range of (re-)interpretations of the fiduciary duties owed by pension funds to their beneficiaries, and thereby develops a hypothesis concerning the most effective political or legal remedy.
Research Findings: Previous commentary suggests that fiduciary duty either already mandates SRI for pension funds, or at least can be made to do so rather easily. In contrast with this, however, this paper finds that none of the considered interpretations is able to justify engagement on social and environmental issues across the board. Indeed, the problem to some extent seems rooted in the very concept of fiduciary duty.
Theoretical Implications: The paper is relevant to current attempts at justifying SRI through reinterpretations of fiduciary duty, provided mainly by legal scholars and practitioners. By addressing the more philosophical issue of how far the concept of fiduciary duty can be "stretched" to accommodate SRI (a project of conceptual rather than legal clarification), it provides an evaluation of the contemporary debate which is independent of squabbles about existing law.
Policy Implications: The paper shows that there are conceptual limits to attempts at redefining fiduciary duty. But this does not mean that pension funds' engagement in SRI is unjustified or unjustifiable more generally. A more promising way to legally mandate SRI may be through what is dubbed independent social and environmental obligations.

Keywords: Corporate Governance, Institutional Shareholder, Legal Origins and Control, Ownership Mechanisms, Pension Fund Ownership

INTRODUCTION

As (potential) owners of companies, investors have a crucial role to play in the corporate governance setting in order to incentivize or force companies to commit further resources to corporate social responsibility. Most power rests with large-scale institutional investors like pension funds, which basically are enormous pools of money invested in a wide array of shares and bonds on the stock market. These funds have really become the dominant players on the world's financial markets over the last 50 years or so. According to a recent report from the OECD (2008), the pension funds of Western countries hold assets equivalent to (on average) 76 percent of the GDP of their respective countries. If pension funds could be persuaded to become so-called socially responsible investors, they would obviously be an important force for corporate social responsibility worldwide.

Socially responsible investment (SRI) can be defined as the practice of integrating putatively social, ethical, and/or environmental considerations into one's financial investment process. Whereas conventional or mainstream investment focuses solely upon financial risk and return, SRI also includes social or environmental goals or constraints in decisions over whether to, for example, acquire, hold, or dispose of a particular investment. This practice has received increased attention over the last couple of decades – according to recent estimates, the total amount of investments with an explicit social or environmental profile is $3 trillion in the US and €5 trillion in Europe (Eurosif, 2010; Social

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Investment Forum, 2010). The factor which many commentators think will determine whether SRI can grow further than this, however, is whether it is a viable form of investment for institutions like pension funds (Hawley & Williams, 2002; Kiernan, 2002; Sparkes & Cowton, 2004). But in what manner or for what reason could pension funds be persuaded to engage in SRI – that is, how could one justify such engagement?[1]

This paper seeks to develop a plausible hypothesis concerning the most effective political or legal remedy in this situation – a hypothesis which may be tested in future empirical research – by addressing a more specific politico-legal problem, namely that arising from pension funds' so-called fiduciary duties. Put briefly, the problem originates from the fact that pension funds manage money that ultimately belongs to someone else – to present and future retirement pensioners – and by law they have certain obligations towards these underlying owners. Among other things, the law states that they are required to manage their funds in the best (financial) interest of the beneficiaries and to do so without attending to personal biases. A vast amount of pension fund trustees around the world interpret this legislation as precluding them from doing anything else than seeking maximum returns on investments, which then is thought to rule out SRI. In a survey among American pension fund trustees, for example, as many as 45 percent indicated that considerations of fiduciary duty were their main reason for not engaging more actively in SRI (Hess, 2007; see also Hesse, 2008; Juravle & Lewis, 2008). But are trustees correct in this negative view?

A large number of commentators, from both academia and the SRI movement, have recently struggled to find a way around the problem. One could say that two kinds of "solutions" have been presented so far. First, some suggest that the view above simply is incorrect; that is, that already the current legislation allows pension funds to engage in SRI. There are two versions of this solution. According to one, it is simply a mistake to think that SRI is incompatible with the duty of seeking maximum returns (Freshfields Bruckhaus Deringer, 2005; Kiernan, 2009; Sethi, 2005; UNEP FI, 2009). According to the other, the mistake is rather in equating fiduciary duty with the duty of seeking maximum returns (Richardson, 2007, 2008; Viederman, 2008). The second kind of solution argues that the current legislation indeed precludes SRI. However, what is needed is simply some reinterpretation of fiduciary duty which puts stronger emphasis on the social and environmental dimensions (Joly, 2002; Lydenberg, 2012; Richardson, 2009). That is, fiduciary duty should "really" be understood in a slightly different manner, and we then need our politicians to update the relevant legal framework.

This paper will take a more pessimistic stance and argue that none of these solutions is likely to work. That is, fiduciary duty cannot be reconciled with SRI; at least not for a sufficiently wide set of social and environmental issues. If we still want our pension funds to be a force for corporate social responsibility through their investment practices, then we must seek justification for this elsewhere.[2] Towards the end of the paper I present a solution involving what is dubbed independent social and environmental obligations. This new solution is a key theoretical contribution of the paper, together with the thorough critical evaluation of the previous literature on (re-)interpretations of fiduciary duty.

It should be noted that my main concern is not with legal matters and how the current legislation should be "correctly" interpreted (a project of legal clarification; for my view on the limitations of contemporary legislation, see Sandberg, 2011). Rather, I will address the more theoretical issue of how far the *concept* of fiduciary duty can be "stretched" to accommodate SRI (a project of conceptual clarification). By carefully going through a range of variations in how the fiduciary duties of pension funds could be (philosophically) understood, the paper provides an evaluation of the contemporary debate which is independent of squabbles about existing law. The ultimate aim of this evaluation is to provide a more robust hypothesis concerning the effectiveness of various political and legal remedies in this context. As a by-product, it is hoped that trustees (as well as researchers in the field of corporate governance) should get a clearer picture of their fundamental investment mandate.

THE LEGAL BACKGROUND

"Fiduciary" comes from a Latin verb meaning "to trust" and, hence, "fiduciary duties" is the common term for the duties which trustees (custodians, fiduciaries) have towards their beneficiaries (receivers, investors). Also corporations and boards of directors have fiduciary duties, which they typically owe to the owners of the enterprise; either private investors or the general public. But my interest here is in the duties owed by pension funds toward their beneficiaries; present and future retirement pensioners.

It should be noted from the start that the extent to which these duties are legally defined, how they are legally defined, and then how they are understood in practice and what specific requirements they impose on pension funds, to some extent varies. First of all, this varies between different countries and jurisdictions – as most discussion has focused on court cases from the UK and the US, these cases may not be relevant in other parts of the world. Indeed, technically speaking, the term fiduciary duty only applies in common law jurisdictions, i.e., in countries where legal rules generally are interpreted in light of relevant court decisions (Freshfields Bruckhaus Deringer, 2005). But most other countries have legislation to similar effects.

Secondly, the content and applicability of fiduciary duties may vary with different types of pension funds. Different rules may apply depending on whether the fund is, for example, open or closed (to a wider cross-section of members), a defined-benefit or defined-contribution plan, and whether it is publicly or privately owned (in the latter case, also whether it is corporate or union sponsored). Many countries also have both self-directed funds (where people partly can choose where to put their money) and funds that are under unified management (where people cannot choose), and there are some important differences between these. But the present paper will try to go beyond particularities and circumstances, at least as much as possible, to discuss matters of principle which should be of more general interest to all trustees.

As a rough and general background to our present discussion, we may say that the fiduciary duties imposed on

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pension funds in most countries consist in two parts (Pearce & Stevens, 2006; Watt, 2006; Whitfield, 2005). First, an idea about adequate aims, namely that trustees are to manage their funds in the interests of the ultimate beneficiaries and not in their own self-interest – this is sometimes called the "duty of loyalty," and may be stated more generally as the duty to act in accordance with the purpose of the underlying trust arrangement; and second, an idea about adequate means, namely that trustees are to exercise due care and prudence when managing their funds – this is sometimes referred to as the "prudent man rule," and is typically taken to imply that trustees should, for example, seek adequate information before making investment decisions, consult with expertise if they are not financial experts themselves, and carefully weigh the expected returns of particular investments against both expected risk and how they fit in with the rest of the portfolio.

The two parts roughly combine into the idea that trustees are to act prudently in the interest of their beneficiaries. But now, what would a prudent man do with a chunk of money to invest? Perhaps it is not so strange that the received view equates fiduciary duty with an obligation to seek maximum risk-adjusted returns on investments. According to the classic and oft-cited commentary of the Chicago law professors Langbein and Posner, this is indeed the correct view. They write: "The duty of prudent investing [. . .] reinforces the duty of loyalty in forbidding the trustee to invest for any other object than the highest return consistent with the preferred level of portfolio risk" (Langbein and Posner, 1980:98). Furthermore, this is then usually thought to forbid trustees from taking various non-financial considerations into account in their investment decisions. As Langbein and Posner put it, "both the duty of loyalty and the prudent man rule would be violated if a fiduciary were to make an [. . .] investment decision based on other objectives, such as to promote [job security or social welfare]" (Langbein and Posner, 1980:98).

This conclusion stems mainly from consideration of the Employee Retirement Income Security Act (ERISA) in the US. However, a similar conclusion is often drawn from the UK court case *Cowan v. Scargill*, where the judge ruled that: "In considering what investment to make, the trustees must put on one side their own personal interests and views. [. . . The investment] power must be exercised so as to yield the best return for the beneficiaries, judged in relation to the risks of the investments in question" (quoted in UNEP FI, 2009:87).

THE POTENTIAL OF THE TRADITIONAL VIEW

Proponents of the SRI movement have long sought to challenge Langbein and Posner's conclusion in various ways (for an early discussion, see Simon, Powers, & Gunnemann, 1972). Judging from recent discussions, it seems fair to say that attempts at justifications embedded directly in the traditional interpretation of fiduciary duty have stirred up the most enthusiasm. Quite clearly, if one could find solid grounds for the legal permissibility – or even necessity – of SRI directly in the duty to seek maximum returns, that would be a justification that even traditionalist business lawyers could understand.

Justifications of this type are central in the "Freshfields Report", a report commissioned by the United Nations Environment Programme's Finance Initiative (UNEP FI) to the law firm Freshfields Bruckhaus Deringer. This report roughly confirms the traditional interpretation of fiduciary duty; i.e., it is argued that pension fund trustees' overriding aim should be to provide financial benefits for their beneficiaries (Freshfields Bruckhaus Deringer, 2005:8–12). However, its originality lies in a series of arguments supposed to show that this does not rule out SRI. Indeed, according to the report's main argument, integrating social or environmental concerns is *obligatory* when such concerns are financially relevant; that is, when a given company's social or environmental performance reasonably can be expected to have an impact on its financial performance or valuation. The authors contend:

> *In our view, decision-makers are required to have regard (at some level) to ESG considerations in every decision they make. This is because there is a body of credible evidence demonstrating that such considerations often have a role to play in the proper analysis of investment value. As such they cannot be ignored, because doing so may result in investments being given an inappropriate value.* (Freshfields Bruckhaus Deringer, 2005:10–11)

The Freshfields Report has been called "the single most effective document for promoting the integration of environmental, social and governance (ESG) issues into institutional investment" (UNEP FI, 2009:13). Even though the report covers a lot of ground, it seems fair to say that most of the recent praise has focused on the argument above (see EPA, 2009; Kiernan, 2009; NRTEE, 2007; UNEP FI, 2009). But how far does this argument really extend pension funds' possibility to engage in SRI?

The issue of the financial relevance of social and environmental considerations has been the subject of a large number of academic studies over the last couple of decades (for some overviews, see Orlitzky, Schmidt, & Rynes, 2003; UNEP FI, 2004, 2006; UNEP FI & Mercer, 2007). In a recent meta-analysis, probably the most ambitious one to date, Margolis, Elfenbein, and Walsh (2007) compared a total of 192 statements in as many as 167 previous studies on the link between what they call corporate social performance (CSP) and corporate financial performance (CFP). The result of their analysis is that the overall link seems "positive but small" (Margolis et al., 2007:2). However, what is most interesting in the present context is the spread or, one could say, the fragility of results unveiled by the analysis. A clear majority (58 percent) of the studies actually found no statistically significant relationship between CSP and CFP, whereas 27 percent found a positive relationship and 2 percent a negative relationship (Margolis et al., 2007:21).

The authors suggest that the variation to some extent can be explained by differences in how CSP and CFP were defined in the studies, and perhaps also by differences in research methodology (Margolis et al., 2007:9, 16–17). Indeed, in a more detailed analysis of the results, they found that some aspects of CSP seemed more strongly correlated with CFP than others (Margolis et al., 2007:17–21). However,

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they hesitate to draw any general conclusions even on these aspects. In the end, the authors suggest that "[t]he variation in results across types and measures of CSP may itself be the most important signal to emerge from the 35 years of research on the connection between CSP and CFP" (Margolis et al., 2007:24).

A lot more can certainly be said about this topic. However, the important point is that this meta-analysis undermines the claim that there is clear evidence that social and environmental considerations always – or even most often – have financial relevance, at least on the level of individual companies and investments. But if this is correct, it seems that the above argument from the Freshfields Report does not extend very far pension funds' possibility for engaging in SRI. Whereas they may be allowed to act on *some* social or environmental considerations under *some* circumstances, they have no legal justification for continuously doing so as a matter of principle.[3] And, therefore, I submit that the above kind of justification is unlikely to succeed in getting many pension funds to engage wholeheartedly in SRI.

Taking a step back from the empirical enquiries, I suggest that the fragility of the results should come as no surprise from a theoretical point of view. We are talking about certain *non*-financial considerations after all, and whether companies choose to engage in corporate social responsibility is supposed to be motivated, at least to some extent, by direct social or ethical reasons quite apart from their motivation to seek maximum profits. Intuitively, then, the relationship between social and environmental factors and financial performance could be a contingent one at best.

REINTERPRETING THE TRADITIONAL VIEW

The traditional understanding of fiduciary duty holds that pension fund trustees should maximize the risk-adjusted returns on investments or, more generally, provide financial benefits for their beneficiaries. But precisely what does this mean? In order to avoid the troubling results above, a first thing that SRI proponents can do is to try to reinterpret the traditional view only very slightly. It may be noted that the Freshfields Report is silent on the issue of over what *timeframe* social and environmental considerations may be financially relevant, and it also seemingly focuses on the level of *individual* companies or investments. Here there are at least two possible alternative interpretations of fiduciary duty.

First, SRI proponents may suggest that pension funds should be more interested in profitability over the long term, and perhaps the connection between CSP and CFP gets stronger with time. This is indeed a fairly common hypothesis among SRI proponents (see Guyatt, 2005; Krosinsky & Robins, 2008; Sparkes & Cowton, 2004). According to Sethi (2005), for example, the fiduciary duties of pension fund trustees require them to base investment decisions on "a careful assessment of long-term risks and benefits of investments" (Sethi, 2005:103). On this note, it is argued that the term "non-financial" considerations is misguided: "The long-term implications of SRI are anything but non-financial" (Sethi, 2005:100). Most importantly, "companies conducting their operations in a socially responsible manner should be viewed as comparatively better and relatively safer long-term investment choices" (Sethi, 2005:101).

A similar stance is held by Monks and Sykes (2006:227), who argue that there are theoretical reasons for thinking that "companies that are run in their underlying owners' long-term interests [. . .] have a vital long-term reputation to preserve" with all their stakeholders. "They will not want to pollute the environment, employ overseas labour in poor conditions, discriminate against minorities, cheat on taxes, etc. They will want contented, well-trained, loyal staff that are proud to work for their company. In sum, such companies recognise that it is in their interests to be good corporate citizens."

Additionally, or alternatively, SRI proponents may argue that pension funds should be concerned with the overall profitability of their *portfolios*, and perhaps the link between CSP and CFP is stronger on a more general level in the economy. This hypothesis is also becoming increasingly popular (see Kiernan, 2007; Lydenberg, 2007; Thamotheram & Wildsmith, 2007), and it is sometimes called "the universal owner thesis," as put forward by Hawley and Williams (2000, 2002). According to their thesis, pension funds typically invest in a very large sample of companies across different industries and places and, therefore, the returns on their portfolios will effectively depend on "the overall health of the economy." Now, while individual companies often may be able to avoid bearing the full costs of their poor social or environmental performance – that is, the costs are "externalized" and CSP is decoupled from CFP on the local level – it is argued that these costs will be borne by other companies in the economy. Hawley and Williams conclude that "a universal owner that really wants to maximize the shareholder value of its portfolio would need to develop public policy-like positions and monitor regulatory developments and legislation on a number of key issues to the economy as a whole" (2000:170), and this form of "[u]niversal monitoring coincides in many important respects with most SRI issues" (2002:167). In other words, pension funds are more likely to maximize portfolio returns if they take social and environmental considerations into account.

It is obvious that both of the suggestions above are interesting from a theoretical point of view, and therefore deserve further attention from investors and scholars alike. But do they really ground an extended possibility on the part of pension funds to engage in SRI? Unfortunately, even proponents of the SRI movement must accept that there is no solid empirical evidence in support of them at the present stage, and so they are best described as optimistic hypotheses. For example, it may be noted that many of the studies included in Margolis et al.'s (2007) meta-analysis above concern exactly the long-term correlation between CSP and CFP, and yet the analysis showed no stable results. Similarly, none of the summaries published by UNEP FI itself show that there always – or even most often – is a connection between CSP and CFP over the long term (see UNEP FI, 2004, 2006; UNEP FI & Mercer, 2007).

Whether there is a connection between the social and financial performance of very large investment portfolios is difficult to test empirically and, to my knowledge, no solid evidence has yet to be presented either way (see Kiernan,

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2007; Thamotheram & Wildsmith, 2007). However, there would at least seem to be anecdotal evidence *against* the universal owner thesis. Many influential scholars have noted the existence of severe externalities also on the societal (or indeed global) level related to issues such as global poverty and climate change (Pogge, 2008; Stern, 2007). According to these scholars, it is exactly the fact that so few companies (and, for that matter, governments) have been ready to bear the cost of these things that has created a need for action on the part of international charities and non-governmental organizations. Furthermore, perhaps there are grounds for questioning whether institutional investors really behave as universal owners in practice, given that their portfolios are so very large (e.g., they are typically dispersed over several asset management companies which make their investment decisions independently of each other) (Richardson, 2008:133–137).

The considerations above suggest that, while SRI proponents may *want* there to be a connection between CSP and CFP, simply wanting something to be the case does not make it so. This point may seem trivial enough, but it highlights a more fundamental problem with all attempts at justifying SRI from an appeal to financial relevance. Arguably, part of the reasoning behind the SRI movement is exactly that SRI *as such* could be a force for penalizing poor social or environmental performance (as noted at the outset of the paper) – that is, that pension funds should be able to *create* a link between CSP and CFP (see Haigh & Hazelton, 2004; Hudson, 2005; Knoll, 2002; Rivoli, 2003). However, if SRI only can be justified by reference to the prior existence of such a link, then obviously we have a problem. Or at least, it is contended, the SRI of pension funds could only be reactive and never truly proactive on this view. Once again, it seems unlikely that the justifications above can get many pension funds to engage in SRI in a wholehearted (and proactive) manner.

THE ETHICAL OPINIONS OF BENEFICIARIES

If it is not possible to justify SRI by an appeal to financial relevance, the obvious alternative seems to be to rethink the exclusive focus on beneficiaries' *financial* interests. We are here leaving the traditional understanding of fiduciary duty behind us but, as we soon will see, many SRI proponents indeed question this understanding. For example, Peter Kinder, president of the largest SRI analyst firm in the US, suggests that "[t]he principle of the beneficiaries' 'best interests' is not restricted to financial benefit. Having regard to ESG issues is about more than financial performance: it is about asking business to move away from prioritising profit over all else" (quoted in Freshfields Bruckhaus Deringer, 2005:28).

A first issue on this new path is precisely what non-financial interests trustees should aim at instead. Judging from the last point above, the most straightforward idea may be that trustees should take their beneficiaries' *ethical* "interests" or opinions into account – that is, beneficiaries' direct views on corporate social and environmental responsibilities. After all, SRI is exactly investment directed by social and environmental concerns. This is indeed the main suggestion in the extensive legal commentary on SRI by Richardson (2007, 2008, 2009, 2011). Richardson rather straightforwardly suggests that:

> *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. [. . .] 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.* (2007:158–159)

Interestingly, this particular quote is talking about existing law – that is, it is suggested that already the current legislation permits trustees to take their beneficiaries' ethical views into account. A similar position is taken by the Freshfields Report, which notes that "[c]ourts in the UK have recognised 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" (Freshfields Bruckhaus Deringer, 2005:12). But we must now ask our perennial question: exactly how far does this provision extend pension funds' possibility to engage in SRI?

The obvious problem with the line of reasoning above, this paper submits, is that different beneficiaries have different ethical opinions – that is, that you get different "values" or "views on social matters" depending on which beneficiaries you ask. In most jurisdictions, a fundamental principle in this context is that trustees are only allowed to exclude investments for ethical reasons when they have reason to believe that *all* beneficiaries consent to doing so.

For example, in a central UK case (*Harries and others v. Church Commissioners for England*), the judge 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" (quoted in Richardson, 2011:9). The reason for this is that trustees are required to treat beneficiaries even-handedly and to not take sides between different groups (this is sometimes called the duty of impartiality, see Richardson, 2011). The Freshfields Report agrees with this in saying that "[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" (Freshfields Bruckhaus Deringer, 2005:12). But what are really the odds of there being many social or environmental issues on which trustees would be able to point to a consensus among all of their beneficiaries; that is, among both present and future pensioners, and also their dependants?[4]

Proponents of the SRI movement may here try a number of counterargument strategies. They may first try to downplay the problem and suggest that the possibility of finding a consensus really depends on the particular ethical issue at hand. At one point, Richardson curiously suggests that the consensus problem is exaggerated: "While disagreements will most likely permeate traditional ethical or religious issues, such as alcohol or gambling", he writes, "substantial

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agreement in other areas may readily arise. For instance, members of a pension fund probably rarely favour deliberate environmental degradation or human rights' violation" (2007:166). It seems plausible that there are some interesting differences between different ethical issues in this way, but in the end it is hard to avoid finding this comment naïve. Even though many pension fund members may think that environmental degradation is ethically problematic to some extent, they will disagree about precisely how unethical it is and what their pension fund should do about it – most importantly, to what extent it is adequate to sacrifice financial returns in order to avoid supporting it (for empirical evidence in support of this, see Beal, Goyen, & Phillips, 2005; Mackenzie & Lewis, 1999; Nilsson, 2009). As far as the concrete ethical choices facing pension fund trustees are concerned, then, the lack of consensus on social and environmental issues among beneficiaries is a very real problem (for more on this, see Sandberg, 2011).

A second kind of counterargument strategy could be to suggest ways of getting around the problem. For example, after acknowledging that it often may be impossible in practice to determine what beneficiaries want, the Freshfields Report unexpectedly suggests that trustees may use certain well-established social conventions as proxies for the ethical opinions of beneficiaries. This may be understood as a suggestion of how trustees can work around the consensus problem. "Whilst there is little guidance directly on point," the report says

> *it can [. . .] be argued that even in the absence of [. . .] express consensus, there will be a class of investments that a decision-maker is entitled to avoid on the grounds that their ESG characteristics are likely to make them so repugnant to beneficiaries that they should not be invested in, regardless of the financial return that they are expected to bring. It is not possible to define the parameters of this class, but it might include investments that are linked to clear breaches of widely recognised norms, such as conventions on the elimination of child labour.* (Freshfields Bruckhaus Deringer, 2005:12)

It is easy to see the point of this suggestion, but once again I am not convinced that it solves much in the present context. It is true that there are some fairly robust social conventions on some of the issues raised by the SRI movement; for example, international treaties on environmental protection and labour standards signed by a majority of nations. But there is simply a vast range of important ethical issues where there are no clear social conventions or international political treaties (Sandberg, 2011). Furthermore, it remains unclear how this suggestion is supposed to square with the original appeal to a consensus among beneficiaries. Even though at least some social conventions (like national laws and international treaties) are the result of democratic processes, for example, this should in no way be taken to mean that everyone agrees with them. Even on the issue of child labor, one may note that some people think that giving the children of destitute families jobs at least is better than letting them starve (Satz, 2003).

Interestingly, Richardson acknowledges the greater complexity of the consensus problem in a later paper (Richardson, 2011). But here he offers a different way to get around the problem. His main suggestion now is that legislative improvements aimed at making beneficiaries more directly involved in their pension funds' decision-making processes may lead to increased consensus on many issues. This is so because "theories of ethical and democratic deliberation suggest that social values can evolve among participants through appropriately structured forums for reasoned discussion" (Richardson, 2011:10). Strengthening the voice of beneficiaries themselves in fund governance thus "provides a concrete way of conveying their views and enabling trustees to make investment decisions legitimated by the imprimatur of the democratic process [– and i]t could even provide a framework for ethical deliberation to guide SRI" (Richardson, 2011:14). I will not quarrel with this suggestion here, except to say that perhaps not all naïvety has been washed away. Presumably, not all ethical disagreements are dissolved by simply sitting down with other beneficiaries and talking it out.[5]

The arguments above all try to mitigate the consensus problem. But a final strategy for SRI proponents in this context could be to simply accept it and embrace its implications. The idea here would roughly be that beneficiaries should be able to choose the ethical direction of their pension fund themselves, and perhaps we also need an expanded market of funds with different ethical outlooks. There is already an element of choice in some pension fund arrangements, as noted above, but this suggestion would go even further in that direction. It is conceded that this suggestion may feel more like a chance than an obstacle from the perspective of pension funds, which could aim to reach new client groups through the use of values-based marketing techniques; and it may also be attractive to individuals that are keen on expressing their values by choosing a fund that suits them.

I cannot discuss all aspects of this suggestion in the present context since that would take us too far off topic. It may suffice to say, however, that the vision we are getting into really is quite different from the vision of SRI proponents. The problem of a lack of consensus among beneficiaries is namely not solely that people may squabble over the details of individual ethical screens used by SRI agents – but also that a vast majority of beneficiaries may not want their pension funds to take other-regarding considerations into account in the first place. That is, most people would probably choose funds that gave little or no attention to ethical considerations. It should be noted that retail SRI funds (sometimes known as ethical funds), although gaining in popularity, still form only a minute proportion of the total investment universe. Furthermore, several recent studies on private SRI investors indicate that, while they are attracted to the philosophy of SRI in general, very few are willing to accept considerably lower profits in return – and, therefore, they typically invest only a small proportion of their holdings in SRI products (see Beal et al., 2005; Mackenzie & Lewis, 1999; Nilsson, 2009).[6]

THE WELFARE INTERESTS OF BENEFICIARIES

The considerations above indicate that appealing directly to the ethical opinions of beneficiaries is unlikely to work. But

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perhaps there are other ways of appealing to the non-financial interests of beneficiaries? In the literature, at least one other interpretation of fiduciary duty along these lines can be found; namely the suggestion that pension fund trustees should act in ways that promote the interests of beneficiaries in a "broader" sense which includes their welfare interests or their quality of life.

This interpretation has been defended by Lydenberg, who writes that: "If fiduciaries are to act in their beneficiaries' best interests, they have an obligation to ask whether their current and future beneficiaries are likely to be objectively better off as a result of their investment decisions. An important part of that assessment of objective benefit will be financial returns, but reasonably speaking, that cannot be the sole consideration" (2012:23). Lydenberg goes on to suggest that fiduciaries should consider the financial strength of local and national governments, the state of the natural environment, the cost of health care, and the prospects for security at home and peace abroad (Lydenberg, 2012:2).

In a similar manner, Joly argues that fiduciary responsibility needs to be reformed to require institutional investors to attend to the "broader welfare interests of their principals" (2002:294). Indeed he suggests that it is both "reasonable and prudent to accept some degree of sacrifice in financial performance in exchange for better health and quality of life" (Joly, 2002:294). The underlying justification is formulated as follows:

> *In the case of long-term savings and pension funds, the interests of owners could, without too much imagination, be understood to include their social and environmental interests in addition to their purely financial interests, insofar as the purpose of money is instrumental rather than an end in itself and if and when the process of creation of wealth is contradictory to the eventual enjoyment of such wealth. This point of view is captured by two rather commonsensical rhetorical questions: what good is money if it causes harm to its owners? What good are competitive returns in collective investment instruments like [. . .] pension annuities if the underlying companies do things that significantly deteriorate public health or degrade the quality of life of the public?* (Joly, 2002:294)

It seems possible to read the above argument in at least three different ways. On one reading, the point is simply that focusing on beneficiaries' financial interests is too simplistic, because they also have other kinds of interests, including social and environmental ones. On another reading, the point is also that these interests may be more important to them than enjoying sizeable retirement benefits. On a third reading, the point is that their properly *enjoying* sizeable retirement benefits actually *requires* the fulfillment of some of their social or environmental interests. It seems to be the third (and strongest) idea that Joly is on to when suggesting that financial benefits would be worthless were beneficiaries, for example, unable to breathe the air around them.

We now need to ask whether the present interpretation of fiduciary duty can be a full vindication of the idea that pension funds should engage in SRI. Unfortunately, there are a number of problems. First of all, there is the familiar kind of problem stemming from the heterogeneity of beneficiaries; that is, that different beneficiaries are likely to have different welfare interests and it is difficult to see how trustees should prioritize between them. More importantly, this paper contends that there is a limit to how much it is plausible to include in beneficiaries' "social and environmental interests". I will try to explain.

Consider, first, issues where the primary reason for action is of a deontological nature; discrimination may be such an issue. Many SRI agents refrain from investing in, or choose to engage in progressive dialogue with, companies that discriminate against women or minorities in their employment practices (Domini, 2001; Sparkes, 2002). But what is the point of doing this? The most straightforward point seems to be to counteract practices that are morally wrong or unjust, which has little to do with anyone's welfare interests. (Although one may certainly suspect that a central motivation concerns the reputation of the relevant corporation and how this impacts on investment returns.) It is, of course, possible to argue that non-discrimination is in the interests of women and minorities and, as these groups also will become pensioners in the future, it may be in the interest of at least some pension funds' beneficiaries. But is not the latter connection far-fetched?

If this example is unconvincing, consider instead issues which primarily concern third parties' interests. As the Freshfields Report suggests, there is a fairly broad societal consensus in Western countries that child labor is morally repugnant. Hence, many SRI agents refrain from investing in, or choose to engage in progressive dialogue with, companies that are suspected of using child labor (Freshfields Bruckhaus Deringer, 2005). But in whose interests is this done? It seems that the natural reply here concerns the affected children (mainly living in the developing world), rather than the beneficiaries of some Western pension fund. These beneficiaries may, of course, care about the children that are affected. It is also possible that at least some of the children will move to the West and end up as beneficiaries of a pension fund. But once again, are not these connections to beneficiaries far-fetched?

The examples above indicate a limit on how far the present interpretation of fiduciary duty is able to justify SRI – and, therefore, a limit on how effective it is likely to be in getting pension funds on board. To put this point bluntly, it is unlikely that doing the right thing always will be in the interests of a given pension fund's members – even if these are more or less the entire population of a Western country, and even on a broader conception of welfare interests. This is an important theoretical point, which is conspicuously missing in the previous literature on the subject.

EXPANDING THE GROUP OF BENEFICIARIES

The final kind of reinterpretation that we will discuss here is one which tries to recast the group of relevant beneficiaries so as to justify pension funds' engagement in SRI in this way. I just said that it seems far-fetched to try to connect all social and environmental problems to the members of a given pension fund. But one may thus wonder whether it is possible to find a different way of delimiting the relevant beneficiaries.

This idea is certainly not as prominent as the previous ones, but some authors in the recent literature suggest that

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trustees' fiduciary duties extend to people beyond their beneficiaries. For example, according to Viederman: "Fiduciaries must also consider the social and environmental consequences for the investors, the beneficiaries and society at large. We are all universal owners, as shareowners and stakeholders" (2008:192). A similar formulation can be found in Richardson's work, although not fully distinguishable from the suggestion discussed above: "In reframing financial institutions, a potential model for reform would be to expand fiduciary obligations beyond the investors they serve to a broader stakeholder community. This would require a redefinition of the law of fiduciary responsibility to require fiduciaries to promote the interests of an expanded concept of beneficiary with broader social interests for sustainability" (2008:540).

It is suggested that SRI proponents that are keen on expanding the group of beneficiaries should take note of the concept of stakeholders invoked above. Speaking in terms of obligations to stakeholders is often a neat way of codifying more elusive social and environmental obligations. In the contemporary literature on corporate social responsibility, for instance, a growing number of scholars support what has become known as the stakeholder theory of the firm, which holds that corporations have ethical obligations not only to their shareholders but also to consumers, employees, suppliers, and local communities. The stakeholder concept is typically defined very broadly in this literature; for example, as "any group or individual that can affect or be affected by the realization of an organization's purpose" (Freeman, Harrison, Wicks, Parmar, & de Colle, 2010:26). Equipped with this concept, SRI proponents could argue in an analogous manner that pension fund trustees have responsibilities also toward destitute children in the developing world, because these are people that (at least potentially) are affected by the funds' actions.

And maybe the stakeholder concept could be expanded even further so as to also justify responsibilities directed toward the natural environment as such. In what is certainly the most opaque part of Richardson's commentary, one suggestion is that we need responsibilities of this kind. In order to find a new "kind of ethics [which] could support an environmentally sustainable system of investment" (2008:529), it is suggested that we must turn to "ecological" or "biocentric ethics" and that we need "a fiduciary standard centering on the concept of 'ecological integrity'" (Richardson, 2008:542). According to the (fringe) philosophers which Richardson cites in this context, it is a fundamental moral mistake to think that human beings have a special place in the world order; quite to the contrary, we must treat ecosystems and natural processes around us as having inherent non-instrumental moral value. That is, rocks and biospheres deserve just as much moral respect as do individual human beings, and can therefore be stakeholders in their own right (cf. Stone, 1987; Taylor, 1986).

There is much to be excited about in this way of expanding the group of people (or entities) toward which pension funds have obligations; although Richardson's sudden turn to ecocentrism may not be convincing. But we must now ask a slightly different question than before, namely whether it makes sense to think of these as *fiduciary* obligations. This paper's plain suggestion is that it does not. In order for someone to be a beneficiary in the standard sense, it seems necessary not only that they "can be affected" by a given pension fund's activities *indirectly*, but that they have a more direct connection to the aims for which the pension fund was set up or for which contributions were paid into it. This argument does not rest on conceptual considerations as much as a concern for practical usefulness and clarity (that is, a concern for how people actually understand the relevant terms). Of course, there should always be room for radical philosophical thinking and "reconceptualizations." But rather than bringing new philosophical clarity to the concept of fiduciary duty, the present suggestion only seems to cause confusion. Perhaps destitute children in developing countries are important stakeholders whose needs really should be considered, then, but it just seems far-fetched to include them among the beneficiaries or members of our pension funds.

To put this in other words: This paper's ultimate contention is that the suggestions above have taken us too far outside the standard realm of the concepts of both beneficiary and fiduciary duty to be fruitful in the context. This has been further illustrated by putting them at the end of a long line of possible (re-)interpretations of fiduciary duty, going from the traditional to the revisionary. To the extent that it still is politically desirable to give pension funds obligations toward an expanded group of stakeholders (in order to make them a force for corporate social responsibility), it is suggested that a more promising path forward is to talk about independent social and environmental obligations. Before leaving, let me say a bit more about this alternative.

INDEPENDENT SOCIAL AND ENVIRONMENTAL OBLIGATIONS

As the term is intended, a pension fund has *independent* social and environmental obligations if it is required to take into account certain social and environmental aspects of the activities of corporations *irrespective* of whether this is in its beneficiaries' interest. We may say that these social and environmental obligations are owed to society and the environment *directly*, then, rather than to the (possible) fact that beneficiaries happen to care about or depend upon these things. Or, what is essentially the same, the reason why pension funds should engage in SRI has to do with social and environmental considerations in themselves, and not with the interests of the funds' beneficiaries. For example, the reason why they should interact with companies on child labor (if they indeed should do so) is not that child labor hurts beneficiaries, but instead that it is morally repugnant and wrong.

As should be obvious from this brief characterization, independent social and environmental obligations may or may not coincide with fiduciary duties under the various interpretations discussed above. At some times and on some issues, the two may complement each other, whereas they most probably will come into conflict at other times and on other issues. This paper does not intend to say anything more substantial about how these things should be weighed against each other in concrete legislation; that is, whether independent social and environmental obligations should

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be allowed to (always or sometimes) trump fiduciary obligations, or the other way around. I may simply warn that the former run a great risk of becoming toothless and pointless if they are not given sufficient priority – for example, if social and environmental efforts are not allowed to cost anything at all (for more on this, see Sandberg, 2011).

On this point, it may be noted that something quite close to independent social and environmental obligations on the part of pension funds already exists in some jurisdictions – or at least there are individual legislative formulations which go in this direction. The guidelines for the public pension funds in Sweden, for instance, rather straightforwardly state that "[c]onsideration shall be given to ethics and the environment," and similar guidelines have also been issued in France, New Zealand, and Norway. Furthermore single-issue restrictions on what investments public pension funds are allowed to pursue have been implemented in Belgium and a number of US states (EPA, 2009; Eurosif, 2010; Oxford Business Knowledge, 2007). However, these guidelines seldom prioritize social and environmental considerations over the fiduciary duties owed by trustees to their beneficiaries. The full phrase in the Swedish guidelines is that "[c]onsideration shall be given to ethics and the environment without compromising the overall goal of attaining a high return" (Hamilton, 2009:5). Consequently, the social effectiveness of these legislative reforms has been questioned (Hamilton, 2009; Richardson, 2009).

I must in the end acknowledge that this paper's proposal simply is a better *structure* for justifying pension funds' engagement in SRI, and therefore many details remain to be filled in before the proposal is usable in practice. Some central issues are, for example, exactly what social and environmental aspects are relevant, what specific investment strategies are most suitable to handle these issues, and to what precise extent profits may be sacrificed? However, many of these details have to be filled in irrespective of the chosen justification. The important point is that talking about independent social and environmental obligations is the theoretically most straightforward way of mandating (or allowing) SRI for pension funds, and also the way that makes most practical sense as illustrated above.

In line with this, the paper's empirical hypothesis is that such obligations also constitute the most effective political or legal remedy for getting pension funds on board. The basic rationale for this is that effectiveness is likely to increase with clarity and directness of message; that is, that pension fund trustees are more likely to act when they are given a clear and direct social and environmental mandate (rather than one possibly hidden in a changing discourse about their fiduciary duties). Furthermore, as we have seen, the other "solutions" are simply unable to justify engagement on a wide set of social and environmental issues. This hypothesis seems to gain at least anecdotal support from the fact that the countries above often are held out as front-runners in terms of both SRI and corporate responsibility. But, of course, my hypothesis can only be fully vindicated or refuted in a close empirical study of what the near future has to bring.

While waiting for governments to implement the necessary legislative changes, this paper has taken a first step towards clearing up the current confusion among trustees, beneficiaries, and politicians alike concerning the proper investment mandate of pension funds. I wish to close the paper by further emphasizing the important but difficult situation of pension fund trustees. As noted at the outset, investors – and especially large-scale institutions like pension funds – have a crucial role to play in the corporate governance setting in order to incentivize or force companies to commit further resources to corporate social responsibility. Unfortunately, the vast majority of current trustees have learned in school (or from business lawyers) to equate their fiduciary duty with a duty to maximize returns, which then is thought to rule out SRI. However, they have probably heard about peers who take a different view and integrate social and environmental concerns in investment decisions. So which side is right?

As long as the current debate about possible (re-)interpretations of fiduciary duty continues, a good deal of confusion is likely to persist. Because, although it is worthwhile and important to emphasize the long-term and non-financial interests of beneficiaries, it simply is far-fetched to try to justify all SRI activities through such (re-)interpretations. But part of the confusion may be removed by distinguishing more clearly between obligations toward beneficiaries, and independent social and environmental obligations. It is hoped that this paper's proposal will help to create a more transparent corporate governance mandate for pension fund trustees.

CONCLUSIONS

A critical issue for the future growth of SRI is to what extent institutional investors such as pension funds can be persuaded to engage in it. This paper has considered attempts at justifying such engagement, stemming from a range of (re-)interpretations of the fiduciary duties that pension fund trustees owe toward their beneficiaries, and thereby developed a hypothesis concerning the most effective political or legal remedy. Previous commentators have suggested that fiduciary duties already mandate SRI for pension funds, because many social and environmental aspects are financially relevant (Freshfields Bruckhaus Deringer, 2005; Kiernan, 2009, UNEP FI, 2009), or because beneficiaries generally care about these issues (Richardson, 2007, 2008). Alternatively, it has been suggested that some fairly straightforward reinterpretations would do the job; through focusing more on long-term financial value (Hawley & Williams, 2002; Lydenberg, 2007) or on the general welfare interests of beneficiaries (Joly, 2002; Lydenberg, 2012). But are any of these suggestions plausible?

By exploring the theoretical and practical limits of the full range of (re-)interpretations of fiduciary duty, this paper has provided an evaluation of the contemporary debate which is independent of squabbles about existing law. And in stark contrast with the previous literature, the paper has found that none of the considered interpretations is able to justify engagement on social and environmental issues across the board. Indeed, to some extent the problem seems rooted in the very concept of fiduciary duty, which ties pension funds to the interests (financial or otherwise) of a rather limited group of people (the beneficiaries) which often lacks direct

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connection to the ethical issues at hand (say, child labor in developing countries). This is an important theoretical finding with practical implications for both policy makers and the current aspirations of the SRI movement.

But the negative results above should not be taken to mean that pension funds' engagement in SRI is unjustified or unjustifiable more generally. The paper has also provided a new theoretical solution including so-called independent social and environmental obligations. The empirical hypothesis is that such obligations will form the most effective political or legal remedy in the situation. Many details remain to be filled in concerning this solution, and I must acknowledge the lack of empirical support for the hypothesis at the present stage. But it should be clear on a theoretical level how the proposal may provide a better structure for (possible) future political support for SRI. The important point is that SRI needs a justification which fits its nature better than the legal construct of fiduciary duty.

Further theoretical research is needed to develop many details concerning this paper's proposal. And, more importantly, further empirical research is needed to determine the exact effectiveness of the proposal, as well as the effectiveness of other political or legal attempts to justify SRI for pension funds.

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NOTES

1. SRI proponents are typically vague on whether pension funds should be *mandated*, or simply *allowed*, to engage more actively in SRI. The term "justified" is intended to cover both options.
2. I should stress that I here follow SRI proponents in assuming that SRI generally is a good thing, and that it therefore is worthwhile to try to find a way for pension funds to be persuaded to engage in it. But this is obviously debatable. For a critical discussion, see Sandberg (2008).
3. It should be noted that here I am interested in whether fiduciary duty can justify funds *acting* on social or environmental considerations, and not simply their "considering" them in general. Moreover, some may wish to formulate the results of the meta-analysis as saying that there is no solid evidence for thinking that integrating social and environmental considerations must lead to financial sacrifice, and therefore pension funds may take such considerations into account as "tie-breakers" when choosing between financially equivalent investment alternatives. This is another argument that can be found in the Freshfields Report, but I will not comment on it here, as I have done so extensively elsewhere: see Sandberg (2011).
4. To my knowledge, no previous studies have surveyed the ethical opinions of pension funds' beneficiaries as such (although such work now is under way). But it seems fair to hypothesize a considerable lack of consensus on a whole range of issues. The skeptical reader may compare recent research on, for example, the public's attitudes toward environmental issues in general (Nisbet & Myers, 2007), or the profiles of private SRI investors in particular (for an overview, see Sandberg, 2011).
5. To be fair, Richardson ultimately acknowledges this when he admits to a risk that "more 'democratic' decision-making might degenerate into an unsavoury battle of competing interests, rather than a harmonious dialogue towards an ethically-guided consensus" (2011:16).
6. For similar reasons, one may suspect that the kind of simple disclosure legislation that a number of countries currently are implementing (i.e., requirements that pension funds disclose to what extent they (for whatever reason) take ESG considerations into account) will not be effective enough to get funds to engage more actively in SRI. For an extended discussion of this, see Richardson (2008).

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