Fiduciary Duties and Sustainable Investment

Introduction

When one considers the enormous financial resources under the control of institutional investors, such as pension funds, it is readily apparent that such investors have the potential to greatly influence the environmental performance of the companies in which they invest. Those advocating the pursuit of environmental objectives by the investment industry usually consider such aims to be included within the broader framework of socially responsible investment (SRI), which seeks to identify governance mechanisms which would make financial institutions more accountable for the social (including environmental) consequences of their investment decisions.¹

However, the fiduciary duties owed by investment decision-makers to beneficiaries have traditionally been understood to place significant obstacles in the way of any decision which might sacrifice financial returns for environmental reasons. Taking a comparative analysis of the principal common law jurisdictions, this paper seeks to explore whether fiduciary duties to invest prudently can be compatible with environmentally responsible investment decisions and, further, to identify and propose legal reforms which might ensure such compatibility and thus encourage and assist investors to take due account of the environmental consequences of their investment decisions.

Socially / Environmentally Responsible Investment

Though there does not exist any authoritative definition of SRI, one leading commentator describes it as an ‘investment process that considers the social, environmental and ethical consequences of investments, both positive and negative’.² This suggests that the environmentally responsible investor might use a process of positive and/or negative screening of potential investments. A negative screen would seek to exclude environmentally damaging products, projects or activities, and thus companies with a poor environmental record, while a positive screen would select companies involved in environmentally responsible practices, products or projects. Other methods of identifying environmentally responsible investments exist, including a ‘best of sector’ approach, which selects companies which perform best in their industry sector as measured against specified indicators, or an ‘index-based’ approach, which selects companies from established indices, such as the Dow Jones Sustainability Group Index. Of course, many investors may take account of environmental issues indirectly, when such issues are financially material, either because they produce a financial benefit (e.g. through a

¹ For a detailed legal analysis of the concept of socially responsible investment, see further B. J. Richardson, Socially Responsible Investment Law: Regulating the Unseen Polluters (O.U.P., Oxford, 2008).
growing market demand for environmentally high-performing products) or because they avoid a financial risk (e.g. the risk of environmental liability). However, it is questionable whether such investment could be classified as SRI.

At any rate, the SRI sector, however defined, accounts for only a small proportion of capital markets. Though it has been estimated that in the US the SRI sector accounts for ‘nearly one out of every ten dollars under professional management’, amounting in 2005 to US$2.29 trillion held in SRI assets, in Western Europe the corresponding figure in 2004 was 3–4 percent of both wholesale and retail markets, in Canada it was 3.3 percent in 2004, and in Australia it amounted to a mere 1.14 percent in 2005. While there are likely to be several reasons behind the limited success of SRI as an investment strategy, it is logical to assume that a traditional and cautious understanding of the fiduciary obligations of investment managers can be counted among them. Indeed, a 2004 Canadian study concluded that ‘current interpretations of the fiduciary duties of pension fund managers may unnecessarily constrain their ability to address the full range of relevant corporate responsibility considerations related to prospective investments’. In many instances, such interpretations may err on the side of caution in the strict legal sense and a 2005 report commissioned by the United Nations Environment Programme concluded that investment managers’ fiduciary duties should not necessarily preclude or overly impede the adoption of SRI practices.

Therefore, it is necessary to clarify whether SRI practices necessarily conflict with fiduciary investment duties de jure and are thus impeded by such duties or, conversely, whether fiduciary investment obligations might actually require careful consideration of corporate social and environmental performance. It is also helpful to examine which reforms to fiduciary duties might effectively assist in promoting the widespread adoption of SRI practices among investment managers. In so doing, this paper will summarise and present existing research analysing fiduciary investment duties in respect of pension funds in selected common law jurisdictions, and does not attempt to examine investment duties in respect of other types of institutional investment managers, nor legal developments in other, non-common law jurisdictions.

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3 See generally, Richardson, ibid., at 148.
5 Avanzi SRI Research, Green, Social and Ethical Funds in Europe 2004 (SIRI Group, Milan, 2004); European Social Investment Forum (EUROSIF), Socially Responsible Investment among European Institutional Investors (EUROSIF, Paris, 2003).
7 Corporate Monitor, Sustainable Responsible Investment in Australia – 2005 (Ethical Investment Association, Sydney, 2005), at 12.
8 Stratos Inc., Corporate Disclosure and Capital markets (National Round Table on Environment and Economy, Ottawa, 2004), at 12.
10 In particular Richardson, supra, n. 2, who examines the relevant fiduciary investment duties of pension fund managers in Australia, Canada, New Zealand, the United Kingdom and the United States.
Fiduciary Investment Standards

Any situation involving the professional management of investment funds is based on a fiduciary relationship between those providing the investment funds and/or on whose behalf such funds are invested, the beneficiaries, and the professional investment manager, the fiduciary. Essentially, this is a relationship of dependency and responsibility, where considerable discretionary power is vested in the fiduciary to act on the beneficiary’s behalf and in the beneficiary’s best interests, and where the beneficiary is precluded from exercising any control over the fiduciary. In addition to this duty to act in the best interests of the beneficiary, the fiduciary must also exercise due care, diligence and skill, the twin duties of loyalty and prudence. Such trusts, creating fiduciary relationships, are the most common means of corporate financing, by means of both pension plans and mutual funds. At any rate, pension fund trustees are clearly fiduciaries and so the duties of loyalty and prudence preclude pension fund managers from engaging in transactions which could be regarded as adverse to the best interests of pension plan members.

1. Prudent Person / Investor Rule

The latter of the fiduciary duties outlined above, the so-called ‘prudent person rule’ or ‘prudent investor rule’, is of particular significance for the introduction of SRI and, consequently, for the validity and viability of any move towards encouraging sustainable investment. The rule has long been concerned with maximizing investment returns and, according to Richardson, it ‘evolved through case law, supplemented by statutory provisions that generally altered it to accommodate the more contemporary practices of institutional investment and the dynamics of modern capital markets.’ However, the duty focuses on standards of fiduciary behaviour rather than on the actual results of investment decisions, and therefore is concerned to ensure that any investment is permissible and selected with care and prudence. Thus, depending on the circumstances, a number of specific duties might comprise the prudent person rule including, for example, that the fiduciaries possess the requisite skill and competence to invest, that they avoid speculative and unduly risky investments, and that they invest in a suitably diverse portfolio of investments.

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Traditionally, the prudent person rule had emphasized risk aversion and the preservation of capital rather than asset growth. In addition, fiduciaries were expected to evaluate risks and returns of each individual investment, rather than evaluating the overall performance of a portfolio. Thus, investments had to be assessed strictly on a case-by-case basis and it was not permitted to offset the risk associated with a specific investment against another, more conservative investment or against the entire portfolio. While this traditional understanding of the rule may have run contrary to maximizing returns on investment, it is also generally regarded as having precluded any socially responsible investments that posed unusual risk, as each investment would need to be assessed and justified on its own terms. However, this position has changed somewhat in recent years with redefinition of the prudent person rule by virtue of the advent of modern portfolio theory (MPT). MPT emphasizes the investment portfolio as a whole and evaluates individual investments on the basis of their contribution to the performance objectives and risk profile of the entire portfolio of investments, rather than in isolation. MPT encourages the combination of investments that do not correlate or that correlate negatively. Therefore, whereas an individual (sustainable) investment in a new environmental technology business might seem too risky in isolation, in combination with an appropriate mix of other investments it may constitute a prudent investment for a fiduciary.

An MPT-based interpretation of the fiduciary duty to invest prudently has been adopted by the courts in several common law jurisdictions, including the High Court of England and Wales, which stated in *Nestle v. National Westminster Bank* that ‘Modern trustees acting within their investment powers are entitled to be judged by the standards of current portfolio theory, which emphasises the risk level of the entire portfolio rather than the risk attaching to each investment taken in isolation.’

In addition, statutory reform in several jurisdictions has resulted in similar reformulation of the prudent person rule. In the U.K., both the Pensions Act 1995 and the Trustee Act 2000 reflect such investment standards. In the U.S., as well as myriad statutes adopted at the State level, federal statutes, such as the Employee Retirement Income Security Act 1974 (ERISA), require that the ‘prudence of a particular investment decision should not be judged without regard to the role that the proposed investment or investment course of action plays within the overall portfolio’. In addition, U.S. State

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19 For a comprehensive survey of relevant statutory reforms, see Richardson, *supra*, n. 2, at 154-158.
20 Section 36(2)(a) and (b).
21 Sections 3(a) and (b), 4(1).
22 ERISA, section 404.
common law rules are often elaborated with reference to the American Law Institute’s 1990 *Third Restatement of Trusts: Prudent Investor Rule*, which requires investors to:
- assess investments not in isolation but by reference to their contribution to the whole investment portfolio;
- rather than merely seek to “maximize” the return of individual assets, to implement a holistic investment strategy that is rational and appropriate to the fund;
- create a diversified investment portfolio; and
- judge the prudence of an investment at the time the investment was selected rather than by hindsight.24

In Canada, the relevant legislation in nearly all common law provinces has been shaped by the model Uniform Trustee Investment Act 1997, which provides for the replacement of the traditional formulation of the prudent person rule with an MPT-based standard.25

In relation to pension fund investment in particular, the 1993 Canadian Federal Investment Rules similarly modernized the applicable rules by abandoning the previous approach of providing a definitive legal list specifying permissible classes of investments. In New Zealand, the Trustee Act 1956 was amended in 1998 to introduce more modern investment standards26 and the New Zealand High Court has held that a trustee’s duty to act with due diligence and prudence was flexible and should reflect changing economic conditions and contemporary investment philosophies.27 In Australia, each of the States has replaced the traditional legal list of authorized trustee investments with a more flexible trustee investment power28 and, in respect of occupational pension plans more specifically, the Superannuation Industry (Supervision) Act 1993 unequivocally requires pension fund trustees to ‘formulate and give effect to an investment strategy that has regard to the whole of the circumstances of the [fund]’.

In Ireland, the courts have for some time permitted trustees to rely upon the express inclusion of broad powers of investment in trust instruments,29 but where the trust instrument is silent on the matter, or lists certain possible investments without excluding others, the powers of investment authorised by legislation apply.30 In all cases, the

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25 Section 01(3)(c).


27 *Re Mulligan* [1998] 1 NZLR 481.

28 For example, New South Wales Trustee Amendment (Discretionary Investments) Act 1997; Queensland Trustee (Investments) Amendment Act 1999; Victoria Trustee and Trustee Companies (Amendment) Act 1995.

29 See *Re O’Connor* [1913] 1 IR 69, at 76 per O’Connor MR: ‘it is in the power of a testator or settler to place in the hands of his trustee money to be invested in the fullest sense of the word.’

trustees must act with prudence and honestly and exclusively for the beneficiaries. The statutory scheme is contained in section 1 of the Trustee Act 1893, as amended by the Trustee (Authorised Investments) Act 1958 and associated subordinate legislation. The statutory powers of investment in Ireland are still set out in a list of authorised investments now contained in the Trustee (Authorised Investments) Order 1998, as amended by the Trustee (Authorised Investments) Order 1998 (Amendment) Order 2002, though the legislative regime also subjects all trustees to a number of general duties, such as the duty to diversify and the duty to engage in active investment, which arguably reflect the requirements of modern portfolio theory. Indeed, in considering the utility of proposing a new legislative provision on adherence to modern portfolio theory, the Irish Law Reform Commission concluded in 2005 that such matters 'properly fall to be considered in the context of trustees’ compliance with the duty of care'.

2. Duty of Loyalty

The second key fiduciary duty, the duty of loyalty, requires that fiduciaries advance the best interests of the beneficiaries and has been interpreted so as to ensure that they act honestly and exclusively for the beneficiaries, thereby preventing fiduciaries from acting for their own or third-party interests. A number of constituent elements have been developed over the years, including the duty to avoid conflict of interests, the duty not to delegate responsibility, and the duty to act impartially towards different beneficiaries or classes of beneficiaries. Traditionally, the duty of loyalty has been understood as requiring fiduciaries to demonstrate that an investment decision is motivated only by the financial interests of the beneficiary, particularly where the purpose of the trust is to provide financial benefits to beneficiaries, such as a pension plan intended to provide future retirement income.

However, in some jurisdictions the law has recently evolved to allow fiduciaries to consider collateral interests of the beneficiaries, such as their status as employees. In

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31 For example, in Re O’Connor, supra, n. 29, O’Connor MR also stressed that trustees must exercise the normal standards of care even when given express absolute discretion in relation to investments, stating at 75-76, that
‘however unlimited the power of investment may be, the trustee remains subject to the jurisdiction of the court.’


34 Trustee (Authorised Investments) Order 1998, Schedule 2, para. 3(1), as substituted by Trustee (Authorised Investments) Order 1998 (Amendment) Order 2002, Article 3, provides that:
(1) In making an investment of trust funds a trustee shall take due account of:
(a) the nature of the liabilities of the Trust,
(b) an appropriate diversification of investments, including appropriate diversification of credit and counterparty risks, and
(c) an appropriate liquidity of investments.


addition, the interests of third parties may be considered, though such interest must be subordinate to beneficiaries’ interests.37 Also, in some situations the notion of a “benefit” may not necessarily be confined to a financial benefit. For example, if beneficiaries clearly share a moral objection to a particular form of investment, it could be construed as being for their benefit if the trust avoids such investment, possibly even at the cost of a lower financial return.38

Implications for Socially / Environmentally Responsible Investment

While it appears that fiduciary investment rules are flexible and broadly applicable, the question remains as to whether such flexibility enables accommodation of non-financial environmental benefits or objectives. Some commentators take the view that the duties of prudential investment and loyalty constrain the scope for SRI generally.39 However, representing the contrary view Richardson concludes that ‘it is far from the case that fiduciary responsibilities forbid or implicitly hinder SRI’.40 He goes on to explain that ‘Rather, both the fiduciary responsibilities of investors and the definition and methods of SRI are sufficiently flexible to allow SRI in some situations. Fiduciary responsibilities may not generally allow financial returns to be sacrificed, but there remains plenty of scope for SRI within the fiduciary framework.’41

In support of this position, Richardson argues that across a range of common law jurisdictions the law has tended to develop so as to impose an overarching responsibility on fiduciaries to promote the “best interests” of their beneficiaries, as opposed to a narrower obligation to pursue their “sole interests”.42 He cites, as examples of legislative measures employing the former, the 2003 EU Occupational Pensions Directive43 and advice provided by the U.S. Department of Labor in respect of application of ERISA, which makes it clear that the statute’s fiduciary standards ‘do not preclude consideration of collateral benefits, such as those offered by a “socially-responsible” fund …’.44 Clearly, investment in environmentally responsible companies will often constitute a prudent investment choice in purely financial terms as environmental risks may be material to financial returns. However, where corporate environmental performance does not correlate to financial performance, such as where governmental or social sanctions against environmental harm are absent or feeble, companies may derive profit from

37 See Richardson, supra, n. 2, at 158 -9.
39 See, for example, Ali and Yano, supra, n. 16, at 128-139.
40 Supra, n. 2, at 160.
41 Ibid.
42 Ibid., at 160-161, though he cites section 62 of the Australian Superannuation Industry (Supervision) Act 1993 as an example of a legislative measure employing the “sole interests” test.
exploiting the environment and more environmentally responsible companies may thus suffer from competitive disadvantage. In such a situation, a fiduciary may be acting imprudently by considering environmental objectives and thus sacrificing financial returns.

Some ecological risks might be considered so serious and pervasive that fiduciaries have a duty specifically to consider the associated financial risks and it is clear that institutional investors have been concerned for some time with the threat of climate change. For example, the Carbon Disclosure Project was established in 2000 to assist major institutional investors to collaborate on the business implications of climate change and the Investor Network on Climate Risk (INCR) was formed in 2003 to promote better understanding at the global level of the financial risks and investment opportunities posed by climate change. By 2007 the INCR included some 50 institutional investors collectively managing US$3 trillion in assets. Corresponding fora exist at the national level to promote similar collaboration among institutional investors. The fact that many institutional investors would manage a broad range of investments, spread across many geographical regions and economic sectors, to which they might be committed on a relatively long-term basis, supports the idea that they might be subject to a fiduciary duty to consider the environmental consequences of their investments. However, such responsibility is based upon the likelihood that their investment decisions would somehow potentially impact adversely on the financial performance of their investments through, for example, government regulation, consumer pressure or other social sanction. Therefore, such investment would tend to follow rather than lead broader societal responses to environmental problems, and then only to the extent that such responses affect financial returns, and so would hardly qualify as SRI, however defined.

Indeed, pension funds in particular exemplify such so-called “universal owners”, holding a broad portfolio of stocks and other assets, and thus being concerned to promote the long-term health of the entire economy. In addition, the financial liabilities of pension funds are long-term in nature and pension fund membership is very widespread in society. Therefore, pensions funds should be particularly well placed to take a long-term view and to be attentive to the environmental performance of their investee companies. Also, in common law jurisdictions, pension fund trust instruments and legislation applicable to pension fund investment generally do not specify the types of investment which the fiduciary must make, but instead provide pension fund trustees with a plenary power of investment. Further, as pension funds are established by contract, though normally constituted as a trust, it is possible that members could acquire specific

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45 See www.cdproject.net The CDP has recently expanded its remit to cover water issues, launching an initiative to encourage listed companies to report publicly on their water management policies and usage.

46 See www.incr.com

47 Richardson, supra, n. 2, at 163.

48 For example, the U.K. Institutional Investors Group on Climate Change, see www.iigcc.org

rights regarding the investment policies of their pension plans by contract, independently of rights established under the trust instrument. In addition, it may be possible to distinguish between defined-benefit pension plans and defined-contribution pension plans. As Richardson points out, whereas the employer or plan sponsor bears the financial risk under a defined-benefit plan,

‘A defined-contribution plan shifts that risk to the employees. Arguably, therefore, those employees should concomitantly acquire greater rights over the pension plan’s choice of investments including SRI options … Where the employer guarantees retirement benefits [under a defined-benefits plan], it is understandable that the employer may wish to exclude SRI if that option would materially risk lower investment returns.’

A sustainable investment policy might operate to hamper true diversification, one of the constituent requirements of the duty to act prudently, where it employs “environmental investment screens” that exclude specific companies or economic sectors. However, “best of sector” methods for pursuing a sustainable investment strategy would allow for retention of a diverse portfolio of investments in accordance with MPT. Also, the duty to diversify might operate to encourage environmentally sound investment choices. For example, investment managers who have traditionally invested in the energy sector might feel compelled to look beyond fossil fuel investments to include renewable energy companies.

Another method of promoting sustainable investment is that of “corporate engagement”, where investors actively seek to influence company management rather than investing passively. Though such methods can entail additional fund management expenses, many commentators would stress that fiduciaries generally have a duty to carefully monitor their investments and actively to protect those investments through proxy voting, engaging in dialogue and other active investment management strategies. In the UK, the Myners Report on institutional investment concluded that, where shareholder activism is in the best financial interests of the beneficiaries, it is ‘arguably already a legal duty of both pension fund trustees and their fund managers to pursue such strategies’. Due to the length of time it can take to take for the risks of environmental harm and consequential legal liability or corporate reputational damage to become apparent, there may be a delay between a company’s financially relevant environmental record and market reaction to such information. Therefore, in certain situations, fiduciaries who passively entrust the market to efficiently take account of environmental behaviour may fail to act in their beneficiaries’ best interests.

51 Richardson, supra, n. 2, at 172.
52 See, for example, Goodman, supra, n. 44, at 32.
Ultimately, the applicable trust instrument is the primary source of rules governing the duties of trustees and their investment decisions. If the instrument expressly requires the trustees to invest according to specific environmental criteria, then they must heed those criteria. However, uncertainty remains over how courts could enforce such criteria or measure damages when fiduciaries fail to invest according to such environmental criteria, particularly where the omission does not cause financial loss to the beneficiaries. One possible legal response, as developed by the Israeli Supreme Court, would be the creation of a new tortious remedy that would focus not on the question of financial damage, ‘but on the grievance to the individual’s integrity or autonomy, manifested in the deliberate disregard of his moral beliefs and preferences’. Investing according to expressly specified criteria is an aspect of the duty of loyalty and so, where the original trust instrument does not specify any environmental criteria, fiduciaries who are concerned to pursue a policy of sustainable investment should consult with the beneficiaries. In line with the policy behind the duty of loyalty, the English courts have made it quite clear that fiduciaries who factor ethical preferences into their investment strategy should ensure that these preferences are those of their beneficiaries and not their own. Though there is always the possibility that beneficiaries may hold conflicting views in respect of non-financial social or ethical objectives, some commentators suggest that this is less likely in the case of environmental benefits. According to Richardson: ‘While disagreements will most likely permeate traditional ethical or religious issues, such as alcohol or gambling, substantial agreement in other areas may readily arise. For instance, members of a pension fund probably rarely favour deliberate environmental degradation or human rights’ violations.’

Indeed, even where the unanimous agreement of beneficiaries to the framing of an environmentally sound investment strategy can be obtained difficulties may remain. In the case of an existing trust it may not be possible to amend a pre-existing investment scheme, as any power of amendment must normally be exercised only for a stated purpose. Therefore, any amendments purporting to authorise investments inconsistent with the original objects of the trust may be invalid. Even in the case of a new investment scheme, statutory restrictions may apply. For example, taxation legislation may only provide tax concessions to trusts established for the sole purpose of providing financial benefits to members, rendering such advantages unavailable in respect of trusts which include environmental objectives.

**Legislation and Case Law Relating to Pension Funds**


55 See Re Clore’s Settlement Trusts [1966] 2 All ER 272, at 275.

56 Richardson, *supra*, n. 2, at 166. See also, Palmer, *supra*, n. 38, at 110.
It is important to note that case law in common law jurisdictions does not appear to suggest that fiduciary duties pose a serious impediment to trustees in pursuing environmental objectives in their investment policies. For example, in the U.K., the leading case of *Cowan v. Scargill*, 57 concerning an attempt by National Union of Mine Workers (NUM) pension trustees to prohibit investment in competing energy industries, might be cited against the taking account of environmental considerations, as Megarry VC held that trustees are bound to treat the interests of the beneficiaries as paramount and that their best interests will normally correspond with their financial interests. However, Richardson points out that the issue of taking into account environmental or any other social or ethical considerations never arose and that the decision ‘does exclude … SRI decisions based on the “personal interests and views” of the trustees, which can “not be justified on broad economic grounds’.” 58 Commenting academically on the significance of the decision, Megarry later explained that fiduciary duties did not require profit maximisation alone and that the offending investment policy might have been better framed as a preference rather than an absolute prohibition. 59 Similarly, in *Martin v. Edinburgh (City) District Council*, 60 though the court allowed a challenge to the decision of the trustees to divest from apartheid South Africa, it did so on the grounds that the trustees had not considered whether the policy was in the best interests of the beneficiaries and had not obtained professional advice. The court did not consider whether such an investment policy was contrary to trust principles *per se*. In fact, Lord Murray also stated that

‘I cannot conceive that trustees have an unqualified duty simply to invest trust funds in the most profitable investment available. To accept that without qualification would, in my view, involve substituting the discretion of financial advisers for the discretion of trustees.’ 61

Though the UK Trustee Act 2000 makes no express reference to SRI, it does require trustees to consider the “suitability” of investments, which has been interpreted to ‘include any relevant ethical considerations as to the kind of investments which it is appropriate for the trust to make’. 62 More specifically, regulations adopted under the U.K. Pensions Act 1995 came into effect in 2000 which require trustees of all occupational pension plans to disclose whether the plan has an ethical investment policy.

The situation is similar in the U.S. In the seminal case of *Board of Trustees of Employee Retirement System of Baltimore (City) v. Baltimore (City)*, 63 the Maryland Court of Appeal approved decisions requiring the municipal pension funds to divest from companies operating in apartheid South Africa. The court accepted that, though the policy excluded

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57 [1985] 1 Ch. 270.
62 See Richardson, *supra*, n. 2, at 177, citing guidance on the key provisions of the 2000 Act provided by the Charity Commission.
63 See further, Richardson, *ibid.*, at 179-180.
a ‘not insignificant segment of the investment universe’, it would only lower the expected investment return by about 0.1 percent. The funds were governed by common law fiduciary duties similar to the federal Employee Retirement Income Security Act (ERISA) standards and the court found ‘Thus, if … social investment yields economically competitive return at a comparable level of risk, the investment should not be deemed imprudent’. The court stressed that the cost of investing in a responsible manner should be minimal and explained that the trustees’ duty is not to maximise return on investments, but only to secure a ‘just’ and ‘reasonable’ return, while avoiding undue risk. The court considered the views of the beneficiaries as well as public opinion, recognising that ‘the Trustees’ prior investment practices offended a growing number of the systems’ beneficiaries and residents of the City’. Indeed, the court appears to have keenly understood the potentially very significant role of pension funds in achieving social objectives by observing that

‘Moreover, given the vast power that pension trust funds exert in American society, it would be unwise to bar trustees from considering the social consequences of investment decisions in any case in which it would cost even a penny more to do so.’

Though the primary Australian legislation governing occupational pension plans, the Superannuation Industry (Supervision) Act 1993, makes no reference to SRI and applies a “Sole Purpose Test” in respect of fiduciary investment duties,64 and though the Australian courts have not yet considered the legality of SRI in the pensions or in other investment contexts, some commentators argue that this test should be interpreted as a “dominant purpose”, which would allow trustees to take social or environmental factors into account.65 It might also be contended that 2001 amendments to the Australian Corporations Act, which introduced obligations regarding mandatory disclosure of any environmental or ethical investment policy, implicitly authorise SRI. Further, the Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2005 allows employees to choose where their contributions are invested, thus enabling them to choose funds that adopt SRI strategies. Indeed, the Association of Superannuation Funds of Australia issued an advisory statement on ethical investment in 2000 which lists the key legal requirements for fiduciaries seeking to invest ethically.66 These include, an unreduced expected return, effective diversification, implementability, member acceptance, and adequate documentation.

Reform of Fiduciary Obligations

Of course, a wide range of types of legal measure might to be employed to achieve an acceptable level of environmental protection including, for example, ‘command and control’ environmental regulation, various mechanisms relating to corporate governance,

64 Section 62. See further, Richardson, ibid., at 181-184.
accountancy rules, the pricing of environmental resources and risks, or taxation incentives, all of which may have a significant bearing on the prospects for sustainable investment. Also, the clumsy imposition in any single jurisdiction or market of binding requirements in respect of environmental or other social investment objectives might result in capital flight or other market distortions. Therefore, it is preferable, at least in the short-term, to promote informational, incentive-based and other procedural mechanisms to create the conditions to foster such investment among pension funds and other investors.

Environmental concerns will often be a material consideration to be taken into account in an investment decision and, though this appears to be permissible currently, policy reforms can encourage this practice. For example, some common law jurisdictions have legislated expressly to allow non-financial SRI criteria to be considered. The Manitoba Trustee Act was amended in 1995 to provide that trustees who do so are not committing a breach of trust subject to any express provision in the trust instrument and provided that they exercise appropriate prudence, discretion and intelligence. In 2005 a similar provision was introduced into Manitoba’s pension legislation. Similarly, Connecticut state pension legislation allows state pension fund fiduciaries to consider environmental and social implications of investments. The Canadian federal government managed Canada Pension Plan (CPP), while retaining the ‘overriding’ responsibility to ‘maximize investment returns without undue risk’, revised its investment policy in 2005 to incorporate policies on social and environmental investment and corporate engagement.67

Legislative requirements for trustee to publicly report on their policies often assist in ensuring that pension funds pursue environmentally sound investment strategies. The UK introduced regulations in 1999 requiring occupational pension fund trustees to disclose their policies, if any, on SRI and on the exercise of shareholder rights.68 The UK approach in respect of disclosure requirements inspired similar developments in a number of jurisdictions including Australia, which adopted in 2001 an SRI disclosure obligation covering pensions, retail mutual funds and investment life insurance products.69

Richardson suggests that ‘merely allowing SRI where it meets “materiality” thresholds or requiring disclosure of applicable SRI policies … may fail to induce changes in long-standing investment practices’ and thus that, ultimately, ‘[P]olicy-makers could insist that investors take social and environmental impacts into account as part of their fiduciary investment duties’.70 Though it is rare for any jurisdiction to adopt a compulsory approach to SRI policies, he further suggests that ‘[T]he precautionary principle could help shape such a restatement of fiduciary responsibilities’ by lowering ‘the thresholds that would trigger a requirement for fiduciary investors to respond to environmental risks’.71 To date very few jurisdictions have followed the obligatory approach adopted by

67 Canada Pension Plan Investment Board, Policy on Responsible Investing (CPPIB, Ottawa, 2005).
70 Richardson, supra, n. 2, at 193.
71 Ibid., at 193-194.
Connecticut and Massachusetts forbidding investment of state or public pension funds in companies or financial institutions operating in apartheid South Africa. New Zealand’s Superannuation and Retirement Income Act 2001 requires that a statement of investment policies, standards, and procedures must cover … ethical investment’. However, no government has yet legislated for mandatory SRI for private pension schemes.

Other possible reforms might involve giving employees or pension plan members the right to elect a certain proportion of trustees or a requirement that investment policies be ratified regularly by a vote of the fund members. Whereas trustees do have obligations to respond to requests by beneficiaries for information, a legal duty could be imposed on trustees to take the initiative to inform or consult with the beneficiaries about the administration of the trust. The EU Occupational Pensions Fund Directive introduces high standards for the provision of information to pension plan members. Legislation might require trustees to attain a certain level of knowledge and understanding of the trust deed and rules and of law and practice relating to trusts and pensions.

**Conclusion**

It appears, therefore, that a strategy on environmentally sound investment can generally be consistent with traditional fiduciary responsibilities, though trustees should endeavour to satisfy a number of requirements. First of all, they normally cannot sacrifice expected financial returns unless the governing trust instrument expressly gives primacy to non-financial environmental goals. Secondly, the restrictions imposed by any environmental policy should not hinder effective diversification. Thirdly, it should be possible to implement the policy without introducing exposure to unacceptable risks or overly burdensome administrative procedures. Fourthly, trustees must take steps to ensure that the policy has wide acceptance among the members of the pension plan. Finally, trustees should maintain adequate and up-to-date records of their decisions and of the grounds on which such decisions were made. Richardson points out that fiduciary duties of pension funds, and perhaps more generally, ‘have evolved over the centuries to reflect modern investment practices’ and that ‘[T]hey are evolving again to reflect impacts of environmental and social concerns on corporate financial performance’.

However, the need for clarity in respect of potentially obtuse environmental objectives is obvious, whether provided by means of the governing trust instrument or legislation. As Richardson concludes in relation to SRI more generally,

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72 Section 61(d).
73 Richardson, *supra*, n. 2, at 197.
75 *Walker v. Symonds* (1818).
76 Article 11.
78 As articulated by the Association of Superannuation Funds of Australia in 2000, *supra*, n. 66.
79 Richardson, *supra*, n. 2, at 199.
‘… because of the arbitrary and subjective nature of some SRI compared to the seeming clarity of traditional fund management objectives to optimize financial returns, explicit guidance on SRI in regulation or the governing trust instruments would be helpful.’

Therefore it is preferable for pension funds wishing to pursue an environmental policy to have an explicit mandate in their governing instrument. In some instances, market forces or voluntary commitments may not be sufficient to bring about meaningful change in investment practices and legislatures may recognise the need to make various types of adjustments to pensions laws in order to foster SRI. The United Nations Principles of Responsible Investment, adopted in 2006 and endorsed by a number of the world’s largest private and state pension funds, sets out best practice standards for environmental assessment, shareholder activism, public reporting and other accountability mechanisms.

The preamble to the U.N. principles declares:

‘As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios.’

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80 Ibid., at 169.
81 See www.unpri.org