

# New Directions in Fiduciary Responsibility\*

By Stephen Viederman

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*Stephen Viederman explores the duty that institutional fiduciaries owe to their beneficiaries. These new responsibilities require prudence and foresight in analysis and investment, not just for short-term profit but for long-term growth, income and sustainability.*

The prudent man standard has long been the standard for fiduciary responsibility. Among the common law duties of a fiduciary were the duty of prudence, the duty of good faith and the duty of impartiality. The fiduciary duty of trustees is understood to include the duty to collect, manage and eventually distribute the assets of the trust according to the contract between the settlor and the trustee. As the law has evolved, fiduciary duties have become codified and have evolved to encompass modern portfolio theory, the ability of the trustee to seek professional financial advice and to delegate discretionary decisions as long as the trustee has exercised due diligence in seeking the professional to whom he wishes to delegate. Just as our idea of prudence and fiduciary responsibility has evolved to encompass

greater financial complexity, the need for specialization and an increasing body of information, so too must the idea of prudence and fiduciary responsibility expand to encompass our greater knowledge of the long term costs and impact associated with investment decisions, environmental pollution, health implications and sustainability. Institutional investors must recapture far-sightedness when it comes to fulfilling their fiduciary responsibilities. It will help to focus on the meaning and implementation of the concept of fiduciary responsibility and the duties of fiduciaries. The *integration* of prudent financial management practices with environmental stewardship, concern for community, labor and human rights, and corporate accountability to shareholders and stakeholders, will minimize short- and long-term



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financial risk and identify investment opportunities that will lead to increased shareholder value.

A focus on institutional investors here does not suggest that the issues raised are not applicable to high-net-worth individual investors, or any other investor concerned with maximizing shareholder value. However, the focus here on institutional investors derives from the fact that they, by virtue of the scale of their collective investments, have enormous influence over financial markets and the global economy as a whole. In 1999, U.S. public pension funds had assets representing 46 percent of the gross domestic product and 33 percent of the capitalization of the New York Stock Exchange.<sup>1</sup> Additional holdings by religious, educational and public institutions, unions and foundations further increase these numbers. They are what investor and shareholder activist Robert Monks, James Hawley and Andrew Williams have referred to as “universal owners.”<sup>2</sup> As a result, these institutions’ financial decisions have a huge impact on society. The collective power of these institutions could reorient companies and economies around the world to secure the short- and long-term interests of beneficiaries, and other shareholders and stakeholders alike.

### What, Then, Is a New Approach to Fiduciary Responsibility for the 21st Century?

Fiduciary responsibility for the 21st century must require

consideration of the social, environmental, political and cultural effects of investments, both positive and negative, over the short and long term as a fundamental part of the investment process. This is a financial issue—one that identifies risks and opportunities not captured by conventional financial analysis. Anything less than this comprehensive view does not meet the needs of beneficiaries or the demands of fiduciary responsibility, as we must come to understand it. This approach is about protecting shareholder value.

Fiduciary responsibility must acknowledge that economic reality must incorporate the social, environmental and financial into a single investment decision-making process if it is to maximize returns both for beneficiaries and the society as a whole. Anything less will be a short-term benefit at best. As corporations begin to better understand the impacts of social and environmental issues on their “bottom line,” so too must institutional investors who hold their stocks.

Fiduciary responsibility must require pension fund trustees to secure their beneficiaries’ future. This obligation has long been recognized. However, as investor and corporate governance activist Robert Monks states, “[T]he primary thing that workers need for their retirement [is] money, but don’t [workers] also need a safe, clean, decent world in which to spend it. These ends are not economically exclusive, institutional shareholders hold not only the proxy power but also the legal obligation to help deliver both.”<sup>3</sup> There is sufficient evidence that an analytic investment decision-

making process integrating social, environmental, political and cultural issues can enhance portfolio performance by recognizing risks and opportunities not reflected in traditional financial analysis while contributing to a safe, clean and more equitable world.<sup>4</sup>

Fiduciary responsibility must be expanded and understood to require voting proxies on shareholder resolutions relating to issues both of corporate governance and social concerns. Proxies are assets to be exercised in beneficiaries’ interest. This is not an argument that there is a “right” way to vote on corporate governance and social issues, where differences can legitimately exist. Many shareholder resolutions can be correlated with increased shareholder value, especially with consumer-oriented companies. What is obvious, however, is that not voting proxies or voting blindly with management is a squandering of assets.

Fiduciary responsibility already requires that trustees analyze apparent outperformers as well as underperformers. Had this been done more systematically, the bubble created by Enron, WorldCom and others might well have been identified as the bubbles they were, and the exuberance they fed might have been avoided at great savings to portfolios. The downside risk of “false hyper performers” is probably far larger than the traditional performance monitoring of visible underperformers.<sup>5</sup>

Fiduciary responsibility necessitates looking closely at the webs of conflicting interests among accountants, auditors, money managers and investment bankers, and institutional finance committees and boards. These webs will

grow more impenetrable unless fiduciaries exercise their duty to the beneficiary in researching and hiring outside portfolio and financial managers.

Fiduciary responsibility must acknowledge the reality of “universal ownership” especially for large institutional investors. Their scale means, in effect, that they are the market. As a result, total portfolios should be monitored in order to maximize portfolio-wide, long-term returns.<sup>6</sup>

## Tasks for Fiduciaries

This vision of fiduciary responsibility carries new and redefined obligations for fiduciaries.

Fiduciaries should be knowledgeable about the social, environmental, political and cultural issues that affect their portfolios and that are an analytic tool integrated with conventional financial analysis. These issues include among others climate change, labor conditions and human rights worldwide, diversity on boards and in the workforce, and product safety, as well as matters of corporate governance. This may entail engaging “social” advisors in much the same way that financial advisors and consultants are employed.

Fiduciaries should use investment managers and consultants that are open to implementing an investment program that incorporates the interrelationships between financial decision-making and social and environmental issues. They should be knowledgeable about these issues, and willing to seek out the skills and resources necessary to implement the investor’s stated directions. This is not portfolio screening. It is a new ap-

proach to fiduciary responsibility and investment decision-making.

Fiduciaries should demand that investment managers and consultants speak and report to them in readily understood English and not in some form of “financese” that ultimately undermines the fiduciaries ability to exercise his/her duties.

Fiduciaries should review their entire portfolios, not only individual assets or even individual asset classes. Single decisions affect total portfolios that in turn have societal effects. For large institutional investors, the bottom line is inevitably portfolio-wide. This requires awareness that negative economic externalities (e.g., pollution) and positive returns in a single company (e.g., pharmaceuticals) may benefit a particular firm the investor owns, but may likely damage the asset value of other firms they own (e.g., smaller firms that are experiencing difficulties in providing health insurance to their employees because of high drug costs).<sup>7</sup>

Fiduciaries should develop proxy-voting guidelines, make them available to their beneficiaries and disclose their actual votes on proxy resolutions. Fiduciaries are the stewards of capital entrusted to them to look out for all their beneficiaries’ interests.

Fiduciaries should demand greater transparency and disclosure from the companies in their portfolios on social and environmental issues as well as issues of corporate governance. Fiduciaries should practice the same levels of transparency and disclosure they demand of companies on all aspects of their activities. This includes reporting to their beneficiaries in language readily available to all concerned.

Fiduciaries should explore the potential of various investment strategies that channel funds into new areas that are socially just and environmentally sound, as well as financially viable. This investment strategy will lead to long-term sustainability and growth and will carry less risk of liability and early failure.

Fiduciaries should ask their lawyers how to accommodate these new responsibilities and obligations, rather than ask if they can. Even in situations where a legislature has directed that the highest financial rate of return is the sole purpose of a pension fund, this new analytical approach to financial decision-making need not be an obstacle. Substantial research shows that consideration of the risks and opportunities that social, environmental, political and cultural issues raise can improve financial performance, or at least have no negative effect.<sup>8</sup>

Fiduciaries should be aware of and become involved in the formulation and execution of public policies that govern financial firms, transactions and markets. This view of fiduciary responsibility involves some obligation to engage knowledgeably in macro-policy decisions and the activities of agencies such as the Securities and Exchange Commission, FASB and state securities regulators, and in related Congressional considerations.<sup>9</sup>

## Conclusion

This view of fiduciary responsibility and the obligations of fiduciaries is not a radical approach to institutional investing. In fact it is very conservative. It makes best use of

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all available information that can positively and negatively affect financial returns. The transparency of analysis and action that results should help address not only long-term societal impacts

of investment decisions, but also immediate needs for greater disclosure from companies.

It is essential to move away from outdated views of prudence and fiduciary responsibility to a new,

broader conception that considers both long-term societal considerations and shareholder value as mutually supportive. Transitions take time, but we must begin now.

### ENDNOTES

\* Expanded version of remarks made at a meeting of the International Interfaith Investment Group, sponsored by the Alliance of Religions and Conservation (UK), New York, June 20, 2002; and at the Green Mountain SRI Summit: A Forum on Environmental, Social, Faith-Based & Sustainable Investing, Stowe, Vermont, Sept. 9, 2002.

<sup>1</sup> ROBERT A.G. MONKS, THE NEW GLOBAL INVESTORS: HOW SHAREHOLDERS CAN UNLOCK SUSTAINABLE PROSPERITY WORLDWIDE,

Table 4.2, at 82 (2001), available online at [www.ragm.com](http://www.ragm.com).

<sup>2</sup> MONKS, *id.*; JAMES P. HAWLEY & ANDREW T. WILLIAMS, THE RISE OF FIDUCIARY CAPITALISM: HOW INSTITUTIONAL INVESTORS CAN MAKE CORPORATE AMERICA MORE DEMOCRATIC (2000).

<sup>3</sup> Robert A.G. Monks, *The Right Response to Seattle's Warning*, THE CORPORATE LIBRARY, Apr. 10, 2000, available online at [www.ragm.com](http://www.ragm.com).

<sup>4</sup> See PETER CAMEJO, THE SRI ADVANTAGE: WHY SO-

cially Responsible Investing Has Outperformed Financially (2002). See also Innovest Strategic Value Advisers, [www.innovestgroup.com](http://www.innovestgroup.com).

<sup>5</sup> Personal communication, James Hawley, Nov. 13, 2002.

<sup>6</sup> HAWLEY & WILLIAMS, *supra* note 2.

<sup>7</sup> *Id.*

<sup>8</sup> CAMEJO, *supra* note 4 and [www.innovestgroup.com](http://www.innovestgroup.com).

<sup>9</sup> Personal communication, Tom Schlesinger, Dec. 5, 2002.

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