New Directions in Fiduciary Responsibility[1]

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The "prudent man," who has long been the standard for fiduciary responsibility, was born near Harvard Square in the 1830s. While playing a useful role for many of the years since, his surroundings have changed significantly, and so must he.

It is useful, however, to look farther back into history – the 14th century-- for the original and, for today, more appropriate definition of "prudent": farsighted and wise. Thus the prudent person of the 21st century must be farseeing, and in particular must look at all facets of the investment process, and use all analytical tools that foresight demands

Institutional investors need to recapture that 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 financial risk and identify investment opportunities that will lead to increased shareholder value.

The focus 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 United States 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's capitalization. Additional holdings by religious, educational and

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[1] Expanded version of remarks made at the 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, September 9, 2002.

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public institutions, unions and foundations further increase these numbers. As a result these institution's 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 requires 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 not screening, nor is it a moral or ethical issue, per se. It 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. This approach is about protecting shareholder value.

- Fiduciary responsibility acknowledges that economic reality must incorporate the social, environmental and financial if it is to be sustainable. Anything less will be short-term benefit at best. The idea of a 'triple bottom line' does not reflect the reality of a single earth and its inhabitants. Programs seeking a double- or triple-bottom line are in the last analysis working toward a single bottom line because there is a synergy rather than a conflict among these issues and financial performance.

- Fiduciary responsibility requires pension fund trustees to secure their beneficiaries' future. This has long been recognized. However, as investor and corporate governance activist Robert Monks states "…the 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."[3] There is sufficient evidence that this analytic approach can enhance portfolio performance by

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[3] Robert A.G. Monks, The Right Response to Seattle's Warning, The Corporate Library, April 10, 2000. www.ragm.com

recognizing risks and opportunities not reflected in traditional financial analysis.[4]

- Fiduciary responsibility requires the voting of proxies on shareholder resolutions relating to issues 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 the obvious point that not voting proxies is to squander asserts.

- Fiduciary responsibility requires that trustees analyze apparent out-performers 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.

- 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 prerogatives as owners.

- Fiduciary responsibility acknowledges the reality of 'universal ownership' especially for large institutional investors. As a result portfolios must be monitored in order to maximize portfolio-wide, long-term returns.[5]

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[4] See Peter Camejo. The SRI Advantage: Why Socially Responsible Investing Has Outperformed Financially. Gabriola Island, B.C., Vancouver, Canada: New Society Publishers, 2002. And Innovest Strategic Value Advisers, www.innovestgroup.com.
[5] James P. Hawley and Andrew T. Williams, The Rise of Fiduciary Capitalism: How Institutional Investors Can Make Corporate America More Democratic. Philadelphia, PA: University of Pennsylvania Press, 2000.

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 which are analytic tools integrated with more 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.

- Fiduciaries should use investment managers who have the skills and resources to implement an investment program that incorporates the interrelationships between financial decision-making and social and environmental issues, and who are also knowledgeable about these issues. This is not portfolio screening.

- Fiduciaries should review their entire portfolios, not 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 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 they own, but will likely damage the asset value of other firms they own.[6]

- 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 beneficiary 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. They will also need to encourage best practice, and better practice.

- Fiduciaries should practice the same levels of transparency and disclosure they demand of companies on all aspects of their activities.

[6] Hawley and Williams, op.cit.

- Fiduciaries should explore the potential of alternative investments and alternative investment strategies to channel funds into new areas that are socially just and environmentally sound, as well as financially viable.

- 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, such as the case of New York, 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.[7]

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 because it makes best use of 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.

The transition from the present view of fiduciary responsibility to a new view may take sometime. As Schopenhauer observed, the difficult takes a while to achieve, the obvious a little longer. But the debate on these issues must begin now to the benefit all beneficiaries, shareholders and stakeholders alike.

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[7] Peter Camejo, op.cit. and www.innovestgroup.com