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Being Virtuous and Prosperous: SRI's Conflicting Goals

Benjamin J. Richardson
Wes Cragg

ABSTRACT. Can SRI be a means to make investors both virtuous and prosperous? This paper argues that there can be significant tensions between these goals, and that SRI (and indeed all investment) should not allow the pursuit of maximizing investment returns to prevail over an ethical agenda of promoting social and economic justice and environmental protection. The discourse on SRI has changed dramatically in recent years to the point where its capacity to promote social emancipation, sustainable development and other ethical goals is in jeopardy. Historically, SRI was a boutique sector of the market dominated by religious-based investors who sought to invest in accordance with the tenets of their faith. From the early 1970s, the aspirations of the SRI movement morphed significantly in the context of the divestment campaign against South Africa's apartheid regime. No longer were social investors satisfied with just avoiding profit from immoral activities; instead, they also sought to change the behavior of others. Business case SRI is a problematic SRI benchmark for several reasons: often there is a countervailing business case for financing irresponsible activities, given the failure of markets to capture all social and environmental externalities; secondly, even if investors care about such concerns, there may be no means of financially quantifying their significance for investment purposes; and, thirdly, even if such factors can be financially quantified, they may be deemed to be such long-term financial costs or benefits that they become discounted and ignored. The ethics case for SRI and ethical business practices more generally takes the view that both investors and the companies they fund have ethical responsibilities that trump the pursuit of profit maximization. Ethical investment should be grounded on this foundation. However, it may not be enough. To keep ethical investment ethical will likely require institutionalizing new norms and governance standards, in such domains as reforming fiduciary duties and the internal governance of financial organizations. SRI's own codes of conduct including the UNPRI have yet to demonstrate the robustness to move the financial community beyond business as usual.

KEY WORDS: socially responsible investing, ethical investing, fiduciary duty

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The conflicting goals of SRI

The movement for socially responsible investment (SRI), which was once more commonly known as ''ethical investment'', increasingly downplays ethics. Historically, it was a different story. The anti-slavery campaigns of Quakers in the 1700s and the financial sanctions against South Africa's apartheid regime during the 1970s and 1980s were motivated primarily by unadulterated ethical concerns rather than the prospect of financial reward. While SRI was historically ignored by mainstream financial institutions such as pension funds and investment banks, their increasing endorsement of it in the last decade has been accompanied by changes in the terminology, methods and meaning of SRI. These investors pitch their case for acting responsibly on business grounds, on the assumption that SRI may make investors prosperous, rather than merely virtuous. However, some significant conflicts may arise by seeking prosperity as a means to be ethical. Sometimes, there is no business case for acting ethically. What then?

In this new mode, SRI may garner attention only to the extent that investors see social or environmental issues as ''financially material'' – in other words, when such issues pose tangible financial risks or opportunities. While this business case approach to SRI is attracting more adherents to the movement, it may merely tinker with addressing the underlying problems such as pollution, poverty and human rights abuses. The prevailing view among many contemporary investors is that the only purely ''ethical'' issues are the traditional concerns of the faith-based investors, such as tobacco or gambling. Otherwise, social, environmental and sustainable economic development problems are deemed to be phenomenon with just differing financial implications.

Yet, ethical investment should no longer be a discretionary choice for financiers, to follow only if there is a compelling business case. All investors, whether or not they profess to follow SRI, should be guided by ethical investment policies. In a world facing grave ecological problems and social and economic

injustices, the financial sector must shoulder some of the responsibility to mitigate these problems (Richardson, 2008). Private investment that has public costs must account for and internalize those costs. Indeed, for many reasons, the financial sector should provide ethical leadership on these issues. The sector, which includes banks, pension plans, mutual funds and various other types of financiers, performs many economically crucial functions including the raising and distributing of capital, and managing financial risks. The 2008 collapse of the sub-prime mortgage market in the USA, which reverberated worldwide far beyond the banking sector, shows how pivotal the financial economy is to the health of the productive economy (Soros, 2008). The financial markets are also where ''wholesale'' decisions concerning future development, and thus eventual environmental pressures, arise. These pressures, once warned the United Nations' Millennium Ecosystem Assessment Board (2005, p. 5), are ''putting such strain on the natural functions of the Earth that the ability of the planet's ecosystems to sustain future generations can no longer be taken for granted''.

Such problems pose significant ethical challenges, the resolution of which will require redefining societal measurements of value and establishing new reasons to act. Business case SRI does not reflect credible ethical standards that can promote sustainability and social emancipation in the public interest over the long term. Market incentives can engender changes only within a rather limited framework that appeals to actors' self-interest. Many contend that only through a new ethical paradigm can humanity evolve sustainably and live in harmony with nature (Devall and Sessions, 2001). In 1992, some 1700 international scientists proclaimed their ''Warning to Humanity'', and called for ''[a] new ethic … towards discharging our responsibility for caring for ourselves and for the earth'' (Union of Concerned Scientists, 1992). Many others agree that progress toward sustainability depends upon challenging the materialistic and self-centered values of industrialized, capitalist society (Light and Rolston III, 2002; Soskolne, 2007). Any other solution would likely respond only to the symptoms, rather than the root causes, of unsustainable

development. In contrast, an ethical view, they contend and we agree, would help decision makers to understand and improve human ethical behavior, providing additional grounds to act when, for instance, financial incentives are absent.

But if mainstream financial actors have long chosen to ignore or downplay *ethical* investment, why would they choose to do so now? How could they be persuaded to act differently? Lofty rhetoric calling for more enlightened behavior on its own will be unlikely to inspire change voluntarily. There are too many countervailing pressures in a competitive market to induce widespread ethical transformation. What is needed is new policy instruments designed to encourage ethically responsible investment practices. Yet, law alone will also not be enough. Whether the law relies on carrots or sticks to induce compliance, the legal system has long been shown to suffer from significant limitations as a means of engineering social change (Teubner, 1987). Law must work in partnership with ethical arguments and moral suasion with a view to giving investors and other business actors convincing reasons to behave lawfully and in an ethically responsibly manner.

This article explores these ethical arguments and the concomitant legal strategies that are necessary to restore an ethical basis to all investment. While the notion of ''ethical'' or ''ethical investment'' is imbued with much complexity and its meanings are contested, we define it to mean decision-making framed and guided by moral principles, such as respect for fundamental human rights and ecological, social and economic sustainability, in contrast to decision-making with its commitment to these values being only instrumental and self-serving.

The remainder of our discussion is structured as follows. Part II theorizes how the social and environmental responsibilities of financial institutions should be conceived. It draws a distinction between the private and public responsibilities of business and concomitantly the changing relationship between the

state as a regulator and the market. Having established why an ethical approach is important in business including financial investing, Part III critiques the dominant ''business case'' approach to SRI, and why it provides no assurance that social and environmental values will be protected and advanced. Part IV examines some of the existing legal mechanisms governing SRI. It also includes a critique of some voluntary approaches to SRI governance, including the UN Principles for Responsible Investment (UNPRI). Part V canvasses potential legal reforms to give better effect to a more ethical approach to SRI. The discussion focuses on the fiduciary duties of investment institutions, because these are the most important legal norms that shape the purpose of investing activity.

Through consideration of these issues, the article aims to contribute to both theoretical understanding of the ethical basis to SRI and legal analysis of how SRI is and should be governed. The article takes an interdisciplinary approach, engaging with scholarship from business ethics, management theory, corporate social responsibility, stakeholder theory and regulatory theory and practice. While we do not dispute that financial institutions are economic actors interested in profitability, it is our view that while a legitimate goal, the pursuit of profits must take place within an overarching ethical framework of decision-making grounded on strong legal and regulatory foundations. In discussing the ethical challenges of SRI, we will often characterize these challenges as one of achieving ''sustainability'' (Richardson, 2006).

Theorizing the ethical responsibilities of investors

The evolving private and public responsibilities of business

Why should investors act ethically? While there is significant literature that has theorized the moral responsibility and legal accountability of corporations and their managers with regard to human rights, labor

standards, environmental protection and other ethically salient issues, the position of investors in those corporations has been relatively neglected. The significant literature on stakeholder theory, business ethics and corporate social responsibility has focused on the position of regular corporations and businesses while saying relatively little about actors in the financial economy. It is important to take the perspectives provided by that literature as a basis for examining the ethical responsibilities of financial institutions. They are, as we will shortly explain, quite closely intertwined positions given the role of investors as private sector shareholders, bondholders or lenders.

Perhaps, the greatest obstacle to accomplishing ethical investment is the currently dominant management paradigm that views the primary purpose of the investor corporation as profit maximization (Bainbridge, 2002, pp. 419–429; Macey, 1991). From the perspective of these theories, if profit maximization requires respect for human rights or pollution abatement, there is no problem. If it does not, as sometimes occurs, then corporations presumably have an obligation to their shareholders not to allow human rights or environmental concerns to impede their profit-maximizing *raison d'être*.

This notion is a result of the particular evolution of the modern corporation. Historically, enterprises were typically granted authority to conduct business for the purpose of achieving some specific public goal. A notable example is the charter granted by the Crown to the Hudson Bay Company to develop Canada's northern regions (Moodie and Lehr, 2008). In the late nineteenth century, the mercantile idea that corporations should be chartered only where their activities would advance public goods was replaced in many jurisdictions with a legislated framework requiring that only those people wishing to incorporate should register their companies following a set of largely formal, and not particularly onerous, bureaucratic procedures. Thereafter, the primary obligation of corporations has come to be seen by many as to serve the interests of their shareholding investors. Concomitantly, for much of the history of the modern corporation, especially since the Second World War, there has been a tacit social contract

between the state and private sector that there would be a de facto division of responsibilities between them, whereby safeguarding the environment and protecting human rights would be a responsibility of governments, while the private sector would be primarily responsible for generating economic wealth (Cragg, 2000). Its practical effect has been to encourage many in the corporate world to view human rights or environmental protection as only indirect corporate responsibilities in the belief that responsibility for setting standards in these areas was solely the prerogative of governments. Concomitantly, references to ''the invisible hand'' of the market have been also advanced to counter the argument that business has obligations to advance public, as well as private, interests (Marris and Mueller, 1980). The assumption is that corporations are the most efficient means of generating wealth, and therefore they should be left to pursue the private interests of shareholders unfettered by concerns for the negative social, environmental or economic impacts of their activities, a range of responsibilities best left to states (Clark, 1986, pp. 20–21, 30–32).

In relation specifically to shareholders, bondholders or other types of investors, there is a further consideration that, in the context of a global economy, they may be too remote from the actions of a corporation. A fund manager in New York or London may have little knowledge of the operations of a firm in a distant country, and which may also represent one of literally hundreds or thousands of companies in a large investment portfolio. It thus could be contended that it is unrealistic to hold investors legally or morally responsible for negative social, environmental or economic impacts of firms they finance.

These kinds of considerations, however, are no longer (if ever they were) grounds to deny the ethical responsibility of investors and their firms to promote sustainability. To explain why, it is necessary to begin by examining the relationship between investors and society including its legal system.

The neo-classical canonical account of the firm is quite compatible with the view that financial

institutions and corporations have an obligation to respect and obey the law, including laws relating to human rights or environmental protection. Indeed, Milton Friedman described the obligation to respect the law as one of the fundamental features of his theory of the firm (Cosans, 2009). However, the justification for this view is not clearly articulated by Friedman or other neo-classical theorists; neither is it acknowledged that the obligation to obey the law has implications for the social responsibility of firms that are much broader than these theorists would concede (Cragg, 2004).

Financial institutions such as banks and investment companies, as with regular corporations, are a legal artifact. They come into existence only where there is a legal framework that creates their institutional possibility. The law makes incorporation possible and creates the legal framework for trusts and other institutional templates that financial organizations utilize. The law also protects investors in companies through the rule of limited liability (Cragg, 2004; Easterbrook and Fischel, 1985). In addition to clothing financiers with a legal personality, the legal system creates the conditions that enable markets to flourish, such as by establishing and protecting the property rights and contractual responsibilities of parties (Sunstein, 1991, p. 608). The legal system is also responsible for an extensive microcosm of rules and procedures that govern how financiers and corporations conduct their affairs in specific situations. These include licenses to operate, permits to emit pollutants and so on.

What is at stake for governments is how best to ensure that economic activity contributes to the public good. It is not acceptable to justify the creation of the extensive national and international legal architecture that frames investment and corporate activity in today's troubled world on simply the right of individuals to invest and make as much money as possible. If the private sector is allowed to pollute and degrade the environment, leading to irreparable harms such as global warming or mass species extinction, its own future is surely also in jeopardy. Likewise, if societies are allowed to disintegrate into violence, widespread poverty and other hardships, business will be deprived of a milieu in which it can

flourish. The private sector has therefore a significant implied interest in maintaining a healthy society and environment, operating under the rule of law, which makes its activities possible and profitable (Cragg, 2004).

In addition to all these reasons why business should act in the public interest, business enterprises have stakeholders. In other words, the activities of banks, mutual funds and ordinary corporations impact on individuals and groups whose interests are thereby affected both negatively and positively. The activities of business thus give those they impact a stake in those activities. A substantial body of literature on stakeholder theory has thus explored the moral principles, and their legal manifestations, which bear on corporate activities as a result of this situation (Clarkson, 1998; Freeman, 1984; Marjorie, 2001; Stout, 2002). Stakeholders, such as workers, local communities, consumers and the environment itself all have moral status that business managers must reckon with. Indeed, some legal commentators have argued that they also may have a legal status in corporate governance, as corporate managers ''have always had some legal discretion (implicit or explicit) to sacrifice corporate profits in the public interest'' and that ''proper economic analysis does not prove this discretion is undesirable or even inefficient'' (Elhauge, 2005, pp. 738–739). One reason for such discretionary authority is that, unlike corporate managers, shareholders may be too distant and insulated from the ''social and moral sanctions'' applicable to corporate conduct that can be costly to a firm if ignored (Elhauge, 2005, p. 740). Among financial institutions, bank managers lending to environmentally problematic projects would likewise have the discretionary authority to be responsive to these social and moral sanctions that arise from relationships with stakeholders.

It is necessary to pause here, in order to elaborate why financial institutions in particular should act ethically to promote sustainability, rather than just to treat this ethical imperative as one for the companies they invest in. Capital financing is instrumental to development choices; those who enable and benefit from

those choices through financial investment should also share responsibility for resulting harms. Financial institutions evolved to mobilize capital and to facilitate financial returns for investors. Anyone who has ever enquired at a bank about a personal loan, credit card or mortgage will understand that financial institutions do not want their capital sitting around idly. Rather, money has to be actively managed and be reinvested to generate profit. This pervasive drive to put capital to use, to make more capital, invariably creates a process that fuels widespread social and environmental changes.

A further consideration in holding financiers accountable, indeed to higher standards than that applicable to the companies they fund, is because of the generally greater economic and environmental salience and impact of financial institutions. The recent sub-prime, mortgage lending crisis in the USA illustrates painfully how failings in one financial sector can produce devastating shock waves across the global economy (Soros, 2008).

Even from a self-interested perspective, financial institutions surely have pragmatic reasons to be socially responsible. Hawley and Williams (2000) argue that large institutional investors, which they describe as ''universal owners'' investing broadly across the economy, have a financial interest in the health and long-term sustainability of the entire economy. This is because, as global, economy-wide investors, they have nothing to gain long term and much to lose by abetting behavior that is profitable in the short run but threatens significant negative impacts for the functioning of the economy or depletion of the natural resources on which economic development depends. Acting as a universal investor implies that what is an ''externality'' at the level of an individual company may show up as a costly ''internality'' for an investor's global portfolio. A related reason for acting responsibly is that large institutional investors commonly hold assets on behalf of millions of individual investors across a large spectrum of society, who presumably share an interest in the health and well-being of the society in which they live.

What is crucially at issue, then, is not simply the end to be achieved, namely a socially just and ecologically and economically sustainable world community, but the allocation and implementation of responsibilities among various economic actors and stakeholders required if that goal is to be achieved. An unchecked free market is certainly not capable of achieving that goal. The assumption that the pursuit of private economic interests will consistently generate substantial economic and other public benefits ignores the significant ''collateral'' social and environmental costs, which are typically borne by those who did not create them (McMurtry, 1998). However, recognition of an ethical imperative to act differently, even by companies in their public statements, has often not altered the underlying behavior of business. Their ability to compete effectively in the marketplace, coupled with prevailing assumptions about their obligation to maximize profits, militates sharply against investors acting ethically. Not even so-called universal owners can necessarily make a difference; even if guided by sound ethical principles, collective action problems remain. Institutional investors cannot easily coordinate their activities to constrain economic growth safely within the overall capacity of the biosphere. The market contains no mechanism to keep economic activity within the carrying capacity of the planet, such as by limiting carbon emissions to avoid climate change (Daly, 1992).

On the other hand, states also can lack the capacity to govern effectively the multifarious social, economic and environmental externalities of the market (Sunstein, 1990; Teubner, 1998; Yeager, 1991). The modern regulatory state using coercive ''command-and-control'' techniques has struggled to control these burdens. The resulting maze of legal controls can reach the point of diminishing marginal returns: the effectiveness of further regulation often being outweighed by the administrative costs and difficulties of ensuring compliance (Stewart, 2001, pp. 30–31). Systems theory explains how the splintering of modern

society into semi-autonomous ''subsystems'', such as the market and the legal sectors, hinders regulation of corporations and financiers. Because they are actors within a market subsystem, their behavior is shaped primarily by the market's norms of exchange, competition, and profitability (Luhmann, 1995). Legal rules at odds with those norms will usually be resisted. Consequently, in recent years many countries have sought to govern the market through market-imitation economic incentives, such as pollution taxes or tradeable carbon emission allowances (United Nations Environment Programme, 2004). While this strategy has also helped to build the business case for SRI, it has not provided a comprehensive solution as economic policy instruments have usually required extensive ''re-regulation'' to be operationalized (Redgwell, 1997, p. 36).

Globalization has also greatly diminished the capacity of national governments to set and enforce meaningful human rights and environmental standards (Falk, 1999; Sassen, 1996; Wolf, 2001). Globalization has not only encouraged the growth of large multinational corporations, some of which control budgets that are larger than the budgets of most national states, it has also entailed the emergence of vast international financial markets that defy effective regulatory control (Alexander et al., 2006, p. 3). Much economic activity is now ultimately a result of the financing decisions of institutional investors, located in global financial hubs such as London or New York that are very distant to the productive economy in which actual corporate development takes place. Concomitantly, globalization had the effect of restricting the ability of nation states to set standards eroded by international free trade agreements, and multilateral investment treaties have eroded the ability of nation states to set standards. International competition for economic investment opened the door to what has been described as a ''race to the bottom'' or a ''regulatory chill'' in the quality, extent and enforcement of social, economic and environmental regulation (Kozul-Wright and Rowthorn, 1998). These conditions therefore require a reappraisal of the social contract between the state and the market in searching for a new approach to promoting

sustainability.

One plausible alternative is for the private sector to assume some degree of responsibility for ensuring that its activities generate public benefits, while relieving states of some of the regulatory burden to promote sustainability. Underpinning the license of investors to operate must be an expectation that their activities will generate public social and economic benefits and avoid harm. The task is not an easy one, partly because of the diffused nature of the public goods and interests at stake. A standard criticism of SRI or other forms of corporate social responsibility is how to define the ethical obligations with sufficient precision to hold the private sector measurably accountable (Watts, 2009). Some SRI issues involve deeply contested ethical issues, such as animal welfare, alcohol, casinos and fertility control. In the absence of an ethical consensus on such issues, either in society generally or within a specific investment fund, law makers may have to settle for procedural reforms such as obliging funds to allow their members to debate the ethical issues at stake and requiring greater transparency about investment policies and their justification. On the other hand, some SRI issues involve market failures where the problem is not that an activity is intrinsically objectionable, but the fact that there is too much of the activity occurring (e.g., emitting greenhouse gases, fishing and cutting trees). Social agreement on controlling these activities is usually much more achievable, although there will of course be differences in determining how to do so and who should pay for corrective action. Thus, not all ethical concerns may be capable of being enunciated as clear normative obligations; some may need to be addressed indirectly through procedural reforms that at most facilitate public debate and better rationalization of decisions.

What then, should the private sector itself do to promote sustainability in a reallocation of responsibilities? Allowing it to regulate itself through voluntary codes of conduct such as the UNPRI is not likely to be sufficient. Unmonitored corporate commitments without sanctions for noncompliance are unlikely to improve corporate behavior when they are costly to implement, something

that corporate behavior suggests is all too pervasive (Klein, 2000; Wood, 2006). Voluntary measures may even be introduced strategically to circumvent official regulation and thereby forestall meaningful change.

Alternatively, some believe that the profit motive itself can be harnessed to give investors a powerful interest in promoting sustainability and acting charitably toward other stakeholders (Donaldson and Preston, 1995). Can a pragmatic, business case provide sufficient motivation for SRI? Are financial institutions likely to honor commitments to behave responsibly where risk reduction or enhanced profitability is unlikely to follow? The record in this respect is not encouraging. The following section examines the limitations of the business case approach to SRI.

Business case SRI

While the SRI movement is seeking greater accountability of the financial sector for the environmental and social problems connected to the economic activities it funds, it is doing so in a manner that works largely within the existing analytical and normative framework of the financial economy (Jeucken, 2001; Labatt and White, 2002). The SRI sector comprises a diverse array of actors with similarly diverse aspirations and strategies, but it is now dominated by institutional and retail investors whose cues are primarily the financial costs and benefits of acting responsibly.

Sustainability issues acquire significance to these investors primarily to the extent that they are perceivable as financially ''material'' (UNEPFI, 2004a). The tools of business case SRI include light-touch investment screens that reject only the most insidious firms (so as not to diminish significantly portfolio diversification and thus returns), polite engagement with corporate management, and more sophisticated analytical methods to assess the financial repercussions of corporate social and environmental

behavior. This approach has been endorsed by international SRI networks such as the United Nations Environment Programme Finance Initiative (UNEPFI). Catering mainly to the institutional investment sector, UNEPFI explains in its report, *Show Me the Money* (2006, p. 4), that: ''[t]he first – and arguably for investors the most important – reason to integrate [SRI] issues is, simply, to make more money…''. In another UNEPFI report (2004b, p. 5), financial analysts are advised to demonstrate ''material links to business value; … [and] avoid moral arguments''. Similarly, in the retail market catering to household investors, SRI funds are commonly marketed in the same manner as conventional portfolios on how they may generate higher returns and outperform the market (Brill et al., 1999).

Not all social investors, however, are so materially self-interested. Some religious investors continue to treat SRI as a matter of ethical necessity (Triolo et al., 2000, pp. 26–53). The churches once spearheaded a divestment campaign against companies profiting from apartheid in South Africa. They continue to be the vanguard of change. An example is the Interfaith Center for Corporate Responsibility's campaigns concerning climate change and environmental justice.[1]

The dominant business case approach to SRI is traceable to theories of shareholder primacy, which conclude that corporate managers, as well as fund managers, pension fund trustees and other investment decision makers have ethical and legal obligations to maximize profits. These obligations flow from the fact that, as agents, managers, trustees and other business decision makers have fiduciary obligations toward their beneficiaries, whether they be shareholders, pension plan members or the like (Langbein and Posner, 1980). Where other stakeholders are concerned, however, the only obligation is to act strategically with a view of achieving business objectives.

Can business drivers lead investors to the same decisions as ethically motivated investors? Respect for the environment or human rights often can have a pragmatic value to financial institutions. It is over the long-

term that being virtuous and prosperous is most likely to be mutually reinforcing. For if economic development is allowed to degrade the environment unabated, a point will surely be reached where natural resources are so depleted or polluted that the economic costs they pose will prevent any further development or raise costs exorbitantly (Daly, 1992). Climate change is an example of a long-term environmental threat with the potential for vast economic costs to investors if left unmitigated. Even in the short and medium terms, the business case can dovetail with ethical considerations in some situations, if the environmental or social costs materialize quickly enough. For instance, increasing natural resource scarcity, for example fossil fuels, can hike up the costs of production and make investment in affected companies less profitable. Human rights concerns can lead to boycotts. Bribery can lead to punitive responses.

One of the most significant challenges to reliance on such approaches, however, is how to integrate effectively qualitative and quantitative, short and long-term, factors into investment decisions. This is an acute problem for many forms of SRI where institutional investors remain sceptical of its economic value. One attempt at a solution is the model of ''comprehensive ethical decision making'' advanced by Brooks and Dunn (2010, p. 205), which combines philosophical analysis and stakeholder impact analysis. The aim is to provide a comprehensive picture and assessment of all variables and to ensure that for example the interests of stakeholders are not trivialized. Another innovation to improve measurement and integration of qualitative, ethical considerations are the new management approaches embodied in the Global Reporting Initiative (GRI) and the ISO 26000 standard. The International Organization for Standardization (ISO) will launch in 2010 its first guidance standard on social responsibility. A voluntary standard, the ISO 26000 aims to ''provide practical guidance related to operationalizing social responsibility, identifying and engaging with stakeholders, and enhancing credibility of reports and claims made about social responsibility'' (ISO, 2010). Concomitantly, the latest GRI (G3) guidelines serve to provide a comprehensive ''sustainability

reporting framework'' for organizations with regard to content issues such as stakeholder inclusiveness, ensuring reliability of information, and providing comprehensive consideration of secondary and indirect impacts and issues (GRI, 2010).

Despite these and other encouraging initiatives, however, given the prevailing business management and investment models, building ethical considerations into strategic and day-to-day decision-making can also constrain profit maximization. Situations where pollution is tolerated or human rights are not respected can offer strategic advantages to investor corporations, such as reduced environmental management costs or lower wage rates in these respective examples (Slapper and Tombs, 1999, pp. 167–170). Thus, acting responsibly can confer disadvantages as well as advantages. So, while the business case for SRI offers pragmatic reasons for ethical investment, it opens the door to pragmatic arguments for investing unethically. For financial institutions that profess to invest ethically but act strategically, the solution to avoid being embarrassed has been to take advantage of the lack of standardization in the SRI market. The laissez-faire market for SRI has allowed a fungible and superficial retail ''ethics'' to proliferate, where salesmanship and marketing may prevail over reflective moral deliberation and principled behavior. Indeed, the average SRI portfolio can be little different to a regular investment fund; a 2004 survey by the Natural Capital Institute concluded that ''the screening methodologies and exceptions employed by most SRI funds allow practically any publicly-held corporation to be considered as an SRI portfolio company'' (Hawken, 2004, p. 16).

Sometimes ''reputational risks'' to companies associated with unethical practices may trigger action. Given that somewhere between 50 and 70% of the business value of many large public companies is attributable to their brand name and goodwill, the risk of a sullied reputation should motivate ethical behavior by high profile firms (Purcell, 2007). Reputation risk is often a key driver of companies' relationships with stakeholders upon whom they may depend for their ''social license'' to operate

(Gunningham, 2009). A World Resources Institute report (Herz et al., 2007) argues that the business case approach can also motivate more respect for the poor and marginalized where financiers find that their projects need community consent and legitimacy. There is strong empirical evidence that corporate executives can be persuaded to act ethically based on the perceived impact on their personal reputation and/or that of their company (Atkins et al., 2006). Even financial institutions face reputational risks if associated with unethical firms. Waygood (2006) has documented how nongovernmental organizations such as the World Wide Fund for Nature have been quite successful in improving the environmental behavior of companies by targeting their financial sponsors through unwelcome publicity campaigns. Nonetheless, reputational risks to investments do not provide a comprehensive solution. Sometimes, the most disadvantaged groups or victims of pollution lack the means to publicize their plight; financiers or firms of low public visibility are not vulnerable to such reputational risks in the first place. Where a financier's concern is reputational risk, the professed commitment to act responsibly can thus amount to nothing more than a good public relations exercise.

There are further reasons why business case SRI is no assurance for meeting the challenges of sustainability. A primary blind spot is that unless social and environmental issues are perceived to have tangible financial implications, investors may ignore them. Often they are perceived as too nebulous for workable financial quantification (McGeachie et al., 2005, p. 57). Values such as biodiversity or climate integrity cannot be captured by conventional financial accounting systems unless they give rise to specific expenses and income attributable to an individual organization (Goodman and Little, 2003). A further, related limitation is that while the SRI community increasingly argues that there is a ''longterm'' business case for investing responsibly on such issues as climate change, the problem is that market pressures to act for the short-term can readily trump perceived long-term costs and benefits. For example, the incentive system for fund managers on shortterm contracts can hinder their willingness to move their focus beyond current performance and

market valuations (Juravle and Lewis, 2008, p. 290).

Just as the business case rationale to act ethically can also under different circumstances motivate unethical conduct, the decision to operate within the constraints of the law, including environmental, economic or social regulation, can also be viewed strategically. Similarly, strategic considerations can also generate resistance to legal reform aimed at making investors accountable beyond the bottom line. In 1996, the US banking industry successfully lobbied Congress to amend the Superfund legislation to obtain a safe harbor from lender liability suits for cleanup of contaminated lands.[2] Also, the mutual fund industry in North America fiercely resisted regulations to make it publicly disclose how they vote as shareholders (Davis et al., 2006, p. 73). In other policy domains such as climate change, toxic pollutants and labor standards, the corporate sector has time and again sought to block credible regulations (Beder, 2002).

Yet, as explained earlier, financial institutions and corporations are *legal* artifacts, which can exist only where legal systems make it possible for them to exist. The private sector can only operate successfully within societies with functioning legal systems. Actions that undermine those legal systems will tend to undermine the success of business itself. A financial institution or corporation, which seeks to respect the law only when to do so has instrumental value for itself, generates policies that directly conflict with the legal framework and practices that are ultimately necessary for the success of that financial institution or corporation. They do not stand apart from society as distinct self-justifying organizations (Cragg, 2004).

Business case SRI thus exhibits substantial flaws. This leaves us with a final question. Can the legal system create a framework to nurture a more ethical and responsible financial sector? The following section explores this issue.

Existing legal reforms for ethical investment

The relationship between SRI and the legal system has only begun to be scrutinized (Richardson, 2008). Until the current global financial crisis, there had been a widespread assumption among policy makers and investors that the market is generally efficient and functions best with minimal governmental oversight. Concomitantly, regulators have connected ecological, economic and social problems only to companies that wield operational control over development, such as mining or manufacturing firms, but not to their financial sponsors. While such assumptions are increasingly questioned, it has not yet led to transformative regulation designed to instill greater accountability on the part of financial institutions. SRI reforms adopted so far have been mainly market-based informational standards that leave fi nciers with signifi nt discretion (Richardson, 2007). For example, most governments' principal response to the financial meltdown of 2008–2009 has so far been huge bailouts of insolvent banks and investment companies with limited attention to fundamentally altering the way they are regulated.

To date, SRI regulation has typically involved process standards, for example, mechanisms requiring financial institutions to report their SRI policies, proxy voting activities and environmental impacts of financial significance. These requirements are designed to enable the assessment and verification of investment policies and performance and, in theory, thereby put pressure on environmental laggards to change or reward leaders through competitive market advantages. For example, in the UK, several other European states and Australia, occupational pension funds must now disclose their SRI policies.[3] In Canada and the USA, mutual funds must disclose their proxy voting policies and voting records when acting as shareholders.[4] Yet, even where these policies are in place, financial institutions are free *not* to invest ethically, so long as they disclose that decision publicly. In practice, their mandated disclosures often entail vague, perfunctory statements that reveal little about the rationale or methodology behind their SRI policies or the quality of their implementation (Fair Pensions, 2006). In theory, procedural standards could usefully nurture

more open and participatory decision-making, as a means of cultivating ethical positions. But there is little evidence to date that currently adopted reforms have enabled such practices.

Consistent with business case SRI, some governments have also introduced economic policy instruments, such as green investment tax concessions (e.g., in the Netherlands)[5] or environmental liability for financiers (e.g., in the USA). In principle, such measures improve the cost–benefit equation in favor of sustainable development. By appealing to financiers' self-interest, they can provide a powerful incentive for financiers to act responsibly. A 2002 study by KPMG found that the Dutch scheme between 1996 and 2002 had delivered e2.8 billion of investment from 140,000 individual investors in over 2,100 projects. Such results, however, hardly justify legislating SRI primarily through economic incentives. Many environmental, economic and social issues are too complex to be broken down into discrete targets to be financially rewarded. Setting goals for reducing greenhouse gas emissions is much easier to measure and reward than maintaining biological diversity or the integrity of entire ecosystems.

Normative standards, which can provide substantive principles to guide investment, are not widely availed in SRI governance. In some jurisdictions, national pension funds are obliged to invest responsibly and ethically. These measures have been adopted in France, New Zealand, Norway and Sweden. For example, the Norwegian Pension Fund is obliged by its governing regulations to ''not make investments which constitute an unacceptable risk that the Fund may contribute to unethical acts or omissions, such as violations of fundamental humanitarian principles, serious violations of human rights, gross corruption or severe environmental damages''.[6] An ethics council guides the fund in discerning ethical investment choices. Based on recommendations of the council, the Norwegian Fund has divested from companies dealing with cluster bombs (Lockheed Martin), nuclear weapons components

(Boeing), breaches of human rights and labor standards (Wal-Mart), and environmental damage (Freeport). A recent survey of the Norwegian and other public sector funds ''highlight[ed] a range of some of the most advanced and creative approaches to responsible investment'' (UNEPFI, 2007, p. 7).

The financial community has also devised its own standards for SRI. A plethora of codes of conduct has emerged in recent years, including the London Principles of Sustainable Finance (2002), Equator Principles (2003) and the UNPRI (2006). Some codes have also been tailored to specific SRI issues, particularly climate change: these include the Carbon Disclosure Project (2000), Carbon Principles (2008) and the Climate Principles (2008). The track record of financial institutions that have voluntarily committed to such standards, however, is generally less than exemplary. These voluntary codes generally do not require signatories to attain any threshold performance as a condition of joining, nor meet any substantive social or environmental standards afterward. The codes' principal requirements are procedural, such as periodic reporting and disclosure of activities.

Consider the example of the UNPRI. It is a succinct code comprising just six principles, each of which is illustrated by several possible actions. Its first principle states: ''We will incorporate environmental, social and corporate governance (ESG) issues into investment analysis and decision-making processes''. Among the list of conceivable actions for the first principle, there is no stated expectation that investors actually incorporate social or environmental factors into their ultimate portfolios. The UNPRI do not require a signatory to demonstrate any particular performance standards with regard to human rights or environmental protection. Conceivably, therefore, a UNPRI signatory could continue to invest in the fossil fuel industry and satisfy the first principle by merely reviewing the direct financial risks posed by global warming. The UNPRI also do not provide an independent audit or verification mechanism to assess the quality of signatories' implementation, a curious omission given how the financier sector in other contexts insists on increased transparency by the firms they fund. The fact that the UNPRI enjoys extensive

support in the mainstream financial sector, including from CalPERS and Stichting Pensioenfonds ABP, should not necessarily be interpreted as grounds for its success. Rather, it might just reflect the easiness of the principles, which leave signatories with considerable latitude to implement the open-ended standards.

More ambitious ethical charters relevant to the financial sector exist, but they have been largely shunned by investors. The Collevecchio Declaration on Financial Institutions, drafted in 2003 by a coalition of nongovernmental organizations (NGOs),[7] lists several rigorous standards specifically for financial markets, based on six core principles, namely: sustainability, ''do no harm'', responsibility, accountability, transparency, and sustainable markets and governance. For instance, the Declaration's ambitious ''commitment to sustainability'' principle obliges signatories to ''fully integrate the consideration of ecological limits [and] social equity … into corporate strategies and core business areas (including credit, investing, underwriting, advising), to put sustainability objectives on an equal footing to shareholder maximization and client satisfaction…''. Yet, apart from the California Public Employees' Retirement System, no financial institution has endorsed the Declaration as of August 2010.

Another ambitious statement of ethics is evoked by the Earth Charter.[8] It was adopted in 2000 following lengthy consultation mainly held among NGOs, and encouragingly has endorsements from some 3,000 organizations and governments worldwide. The charter contains several principles relevant to the business sector, including: ''[e]nsure that economic activities and institutions at all levels promote human development in an equitable and sustainable manner''. While quite a few business organizations have endorsed the Earth Charter, they have probably done so because the Charter's provisions are so broadly stated that signatories cannot be measurably held to account and the Charter lacks the machinery to enforce compliance.

We need then to consider legal reforms designed to promote ethical investment. This should not be taken to imply that the law alone can ensure that investment policies are operative within ethical

frameworks. What the law can accomplish is contingent on the kind of economic, cultural and political conditions in which it functions. Crucial to the success of legal strategies in this respect are ethical arguments and debates that can help persuade financial institutions and investors to act ethically.

Promoting ethical investing through fiduciary duties

The ethical and legal baselines

So how then might we improve the ethics of ethical investment? How should ethical investment frameworks and principles be determined and by what means should they be advanced? As previously explained, some ethical issues on the SRI agenda involve highly contentious activities, such as tobacco production or fertility control, where there is widespread societal disagreement. But there are other activities, such as pollution, overfishing and deforestation. These are examples of market failures or tragedies of the commons, which ultimately can be as devastating to the economy as to the environment. These concerns are amenable to ethical standard setting and legal regulation with a view to ensuring that economic development is conducted sustainably. Breaches of human rights, another concern of many social investors, do not per se involve market failures. Yet, they may also be actionable because there can exist widespread social agreement on the value of these rights, for example protection against racial discrimination.

A second important consideration to note at this stage is who are the investors to whom these ethical issues or controversies apply? We can distinguish between individuals who invest on their own behalf (commonly known as ''retail investors'') and financial intermediaries, such as pension funds or life insurance companies, which invest on behalf of others. There will always be some room for individuals to choose

lawful investments according to their own moral scruples by avoiding companies that engage in activities they find personally offensive, whether it be selling alcohol or operating a casino. But where financial institutions manage the assets of millions of people and have the capacity to exert huge economic influence, it is important to ensure that they are governed by environmental and social standards that avoid exacerbating the market failures or human rights abuses described above. They should be regarded as institutions with identifiable public responsibilities.

In determining what standards financial intermediaries should follow, the law of the land is not an adequate moral compass. If it were, then it would follow that if a corporate development such as a mining project was ostensibly lawful with the requisite licenses and other regulatory approvals, then it would be perfectly acceptable for an ethical investor to fund that project without regard for its social or environmental impacts.

Legal systems often fail to supply adequate social and environmental standards. Legal theorists have long identified a series of explanations for this problem, which include the ability of powerful corporate interests to ''capture'' the regulatory process and block the enactment and implementation of laws unfavorable to their interests (Laffont and Tirole, 1991). Further, in some countries, particularly in emerging economies, the state is weakened by corruption, civil strife, insufficient resources and other factors that undermine its capacity to fulfill its responsibilities (Brinkerhoff and Brinkerhoff, 2002). Examples are widely thought to include the Congo, Sudan and Pakistan. It would thus be preposterous to suggest that merely because a mining project in such countries is ''lawful'' that it meets adequate ethical investment standards. Given that one of the traditional purposes of SRI has been to advance change, to push corporations beyond the letter of the law, it would seem counterproductive to be guided only by the existing legal baseline.

Finally, the law is not an adequate SRI benchmark because it is often unclear what ''the law'' is. Typically, most corporate activities or products are subject to impact assessments, permits, and other

checks where regulators wield significant discretionary power to make decisions on a case-by-case basis. Further, complex interactions between different areas of law may arise; for instance, an emission license does not necessarily shield a polluter from other legal actions such as tort suits.[9] There is also the role of international law to consider: what may be lawful in an individual nation may run afoul of international standards set by organizations like the International Labour Organization (ILO).

Existing fiduciary law and SRI

What this discussion suggests is that ethical investment requires its own legal apparatus that directly targets the financial sector. The fiduciary duties of financial institutions are the most legally significant part of that apparatus, although presently they are generally not conducive to ethical investment. The legal system imposes fiduciary standards on financial intermediaries to invest carefully in the interests of their beneficiaries and in accordance with the purpose of the particular fund.[10] A fiduciary relationship involves a duty of loyalty, requiring the fiduciary to act in the beneficiaries' sole or best interests (Langbein, 2005). The fiduciary also has a duty of competence, requiring skill and diligence, which is usually expressed in the investment context as the ''prudent investor rule'' (Longstreth, 1986).

Fiduciary standards constrain SRI in principally two ways. First, there is a widespread presumption that the best interests of the beneficiaries of a fund are of a financial character. Some British court rulings such as in *Cowan v Scargill*[11] and other cases[12] suggest pension funds are liable to their beneficiaries for losses if they sacrifice financial returns at the altar of ethical principle. Of course, if the governing deed of a financial institution expressly requires social investment to further a specified mission, then the fiduciary must fulfill the specified criteria unless legislation dictates otherwise.[13] Investment by charitable foundations can

fall into this situation. However, typically the directors of banks and other financial institutions do not owe these kinds of fiduciary duties to their institutions and shareholders. Rather, their fundamental legal responsibility is to act in a financially prudent manner.[14]

The second seminal way that fiduciary duties frustrate SRI is by relegating whose money an institution is responsible for investing to a passive role (Alexander, 1993). Rather than treating beneficiaries in pension plans as self-governing and responsible owners, fiduciary rules reduce them to a largely passive and voiceless status in investment decision-making, usually entitled only to be ''informed'' about how fiduciaries, those responsible, invest their assets. Unless required by special legislation, fiduciaries need not consult with beneficiaries. They only need to act in their ''best interests''. They do not need to ask whether those whose funds they handle understand what their best interests are. Fiduciary duties were first seen as a hindrance in the 1980s during the South African divestment campaign (Troyer et al., 1985). Today, the impact of fiduciary duties on a much more heterogeneous SRI agenda is under increasing scrutiny. The World Economic Forum (2005, p. 10) has recommended that authorities ''[m]odify pension fiduciary rules which discourage or prohibit explicit trustee consideration of social and environmental aspects of corporate performance''. A report commissioned by UNEPFI (Freshfields Bruckhaus Deringer, 2005, p. 13) has suggested that ''integrating [SRI] considerations into an investment analysis so as to predict more reliably financial performance is clearly permissible and is arguably required in all jurisdictions''. But this recommendation assumes a business case perspective. A successor report issued by UNEPFI in 2009, examining developments in fiduciary law since the Freshfields report, concludes that ''some institutional investors still appear to be uncertain about the breadth of their discretion to consider [environmental, social and governance] issues'' (UNEPFI, 2009, p. 64). Further, some legal commentators suggest that many of the practices of the SRI industry today are of ''doubtful legality'' (Thornton, 2008, p. 415) from a fiduciary perspective.

To date, there have been very few reforms that allow fiduciaries to give independent weight to third party interests. In the USA, Connecticut legislation provides that managers of the State Retirement Plans and Trust Funds *may* consider the environmental and social implications of investments.[15] But whether they can do so at the expense of financial returns is unclear. In Canada, Manitoba's *Trustee Act* was amended in 1995 to permit trustees to consider nonfinancial criteria in their investment policies, so long as ''the trustee exercises the judgment and care that a person of prudence, discretion and intelligence would exercise in administering the property of others''.[16] However, taking nonfinancial considerations into account is discretionary, nor does a discretionary standard allow affected third parties to enforce their interests. There is a difference between taking the interests of other stakeholders into account and *owing a duty* to those parties. The duty of loyalty that a fiduciary owes remains to the fund's beneficiaries under these reforms.[17]

Mandatory corporate responsibility legislation in company law, however, is not unprecedented. A rare example is the UK's *Companies Act* of 2006, which comes ''close to a stakeholder model of director's duties'', according to Williams and Conley (2007, p. 354). Section 172(1) of this statute requires the directors of a company in promoting the success of their firm to ''have regard'' to ''the impact of the company's operations on the community and the environment''. Breach of this duty could make a corporate transaction voidable and result in civil liability to directors. Applied to financial institutions, such a standard could help to redefine fiduciary duties of institutional investors along the lines of Hawley and Williams' (2000) ''universal owner'' thesis. The financial success of institutional investors, with economy-wide portfolios, is unlikely to be insulated from the social and environmental stresses that a single corporation may avoid.

Reforming fiduciary finance

Reforming fiduciary duties to resolve the conflict between profit maximization and ethical investment is not straightforward. Aside from the political problems in mustering support for such a legislated reform, considerable practical difficulties in designing a credible legal standard exist. It would be unworkable if financial institutions were merely accountable to vague prescriptions such as to ''promote sustainable development''. Like the broader societal debates about sustainable development, such a general goal would be subject to discretionary interpretations that would allow problematic tradeoffs and perfunctory implementation. It would therefore need to be embellished with prophylactic rules. But if they could be successfully redefined, financial institutions that failed to meet them could be subject to various penalties, ranging from damages suits brought by aggrieved fund members to regulatory sanctions including future restrictions on their investment choices or financial penalties to reflect social costs.

Social accounting and sustainability indicators provide metrics that could help quantify social, economic and environmental performance to underpin a new fiduciary standard. But they may be too complex to administer. They may also have the effect of reducing ethical principle to procrustean mechanical formats. Social accounting aims to measure the collateral benefits (e.g., public infrastructure and environmental protection) and costs (e.g., damage to natural environments) of economic activity (Quarter et al., 2003; Unerman et al., 2007). Social accountants, however, have yet to devise means to valuate all social or environmental impacts. Further, this approach if achievable would require fundamental changes to the prevailing generally accepted accounting principles (GAAP). So far, social accounting has mostly resulted in satellite, narrative reporting schemes, such as ''management discussion and analysis'' sections in corporate financial statements.

Sustainability indicators have likewise remained somewhat of an experimental concept. They allow progress toward sustainability based on certain social, environmental, economic and other markers that can be tracked over time (Bell and Morse, 2008). They can also assist decision makers by translating

ecological, economic and social data into performance standards that can point to impending problems. While sustainability indicators can be just as complex methodologically as social accounting metrics, they do not per se require financial quantification and they do not dictate *how* to meet underlying performance standards.

To date, however, the design of adequate sustainability indicators for financial institutions' portfolios has not been accomplished. One innovative attempt to quantify an important externality of an entire investment portfolio is Trucost's annual ''carbon counts'' survey, which measures and ranks UK investment funds according to the carbon intensity of their portfolios (a seminal indicator of sustainability). Its evaluation of 185 investment funds in 2007 found that 25% of the so-called SRI funds polluted more than the average conventional fund (Trucost, 2007). As for social accounting, some activities or impacts likely cannot be quantified for the purposes of a sustainability indicator. One example is the evaluation of the social equity in the distribution of the benefits and burdens of use of the environment.

Metrics for reforming fiduciary duties would be most appropriate for addressing market failures such as greenhouse gas emissions or toxic pollution and, somewhat more challengingly, social harms including transgression of basic human rights. But what about the ethical issues where there is no ''ethical custom'' to guide standards, such as contraception technologies, animal experimentation or vulgar entertainment? Public opinion is greatly divided on the ethical status of such issues. Some legal scholars thus cite these examples as reasons not to change fiduciary duties. Thornton (2008, p. 419) argues: ''[w]hat is considered to be 'ethical' in investment terms is inherently subjective, imprecise and continually changing with altered societal perspectives: a difficult basis on which to found legal reform''.

In such circumstances, rather than attempt to simplify complex ethical issues and debates into discrete standards, law reformers could less ambitiously alter financial decision-making procedures to

oblige fiduciaries to consider the ethical ramifications of their decisions and to report publicly on their decisions and rationales. While in some jurisdictions, pension funds are already required to disclose publicly their SRI policies, presently they generally do not need to disclose *how* they implement such policies or *why* they chose such policies. One could even require such disclosures to be audited by third parties to ensure their accuracy.

Another procedural reform would be to democratize decision-making processes. Watt (2006, p. 437) has suggested that fiduciaries could be placed under a legislated duty to consult with their beneficiaries and to consider their opinions when formulating investment policies. As for consulting with other stakeholders, already the Equator Principles of 2003 require signatory banks to consult with local communities, who may be affected by projects they plan to finance. One rationale for these consultative mechanisms is that the governing boards of pension trusts or investment funds are typically drawn from a narrow segment of society and may lack expertise on SRI issues (Gribben and Gitsham, 2006). Nonetheless, the problem with reforms that seek to give a voice to the beneficiaries of a fund or other stakeholders is that the views of a minority may be overridden where there is no consensus of opinion, and the relative *weight* that fiduciaries attach to the various views cannot be readily scrutinized. Where a fiduciary must consider numerous, conflicting interests without any way of prioritizing among them, any decision taken that is not blatantly selfinterested may become defensible.

A potential remedy to these problems might be to create a voice for stakeholders in an external entity, such as a national ethics council. The state could appoint a body of representatives from key constituencies to devise standards for ethical investment. Fiduciaries would receive guidance on difficult ethical questions, avoiding trial and error. Sweden and Norway have already established ethics councils to guide their public pension funds and, in the case of the Norwegian council, it has made recommendations to divest from companies such as Wal-Mart and Barrick Gold, which have been accepted by the fund

administrators (Criscione, 2009).

This article is not designed to provide a comprehensive analysis of other legal reforms that could strengthen the prospects for ethical investment. A few brief comments regarding other potential collateral reforms, however, are in order. Fiduciary duties, no matter how restructured, will not encompass all financial activities. For example, in the retail investment market, mutual funds have much more flexibility in their investment choices and conceivably can cater to any values investors demand including those oppressive to human rights or the environment. Therefore, other kinds of policy tools must be harnessed to capture the diverse array of financial entities and transactions. As a priority, reformers must seek to improve the quality of corporate environmental and social reporting. Having companies report regularly and comprehensively on their environmental, economic and social activities and impacts can help generate reliable information that can be used to inform SRI choices (Harte et al., 1991).

Corporate governance must also be reformed. The importance of democratizing governance within financial institutions has already been noted. Comparable reforms at the corporate level are necessary given that ethical investors sometimes rely on shareholder advocacy as a means of changing recalcitrant firms from within (Del Guercio and Hawkins, 1999). In some jurisdictions, significant barriers to shareholder activism persist, such as restrictions on the type of issues that can be raised in a shareholder resolution and the passive culture of voting fostered by proxy contest rules (Sarra, 2003). At an international level, states should negotiate agreements setting social and environmental standards for transnational finance. In a global economy, SRI governance can hardly continue to rest solely on disparate national standards (Doering et al., 2002,

p. 54). International-level financial regulation would mitigate a deleterious race to the bottom, as common standards should reduce the incentives for financiers to flee to the most regulatorily benign markets. The existing voluntary international standards, such as the UNPRI or the Equator Principles, are not

sufficiently rigorous to change the status quo.

Conclusions

While the SRI market is ostensibly flourishing, the financial economy remains largely unchanged. An unresolved tension between the financial and ethical aspirations of SRI persists. Some investors may acknowledge environmental, economic or social problems where they are financially material to the bottom line. The business case model of SRI, however, sanguinely transforms the tensions between environmental protection or social justice and profitable investment into a seemingly harmonious and synergistic relationship. Socially responsible investment is then loaded with rhetoric on how being virtuous can enable one to be prosperous.

This is not to deny that sustainability or SRI and business success can be compatible. Based on a philosophy of financial materiality, the business case may address some environmental and social problems through improved research and analysis. However, it cannot accommodate those issues not valued by the market. Further, unless financial advantage can be demonstrated, pollution or social inequities or economic injustices will be ignored especially in the absence of effective government regulation and stakeholder pressure. Indeed, a countervailing business case might to the contrary justify ignoring or tolerating socially, economically or environmentally unsustainably practices.

Encouraging investment guided by ethical values and principles will necessitate significant regulatory change. Legal systems have the capacity to translate a society's values and expectations into workable policy instruments. For SRI to have a significant ethical impact, the reformulation of fiduciary duties is crucial as they define the core goals and processes of decision-making within financial institutions. By redefining fiduciary duties, investor ''benefit'' can be reconceptualized and sustainable development made a

legally grounded investment priority. The law, however, cannot stand alone. Both the law and legal reform will need to be grounded on ethical justifications that can motivate companies and investors to improve their behavior. Conversely, ethical investment will be resisted if investors regard it simply as a regulatory prescription. There must be room for some ongoing ethical reflection designed to illuminate the importance of ethical investment where the pursuit of profits collides or appears to collide with a commitment to sustainable development and ethically grounded investment policies and practices.

Notes

[1] See http://www.iccr.org/issues/globalwarm/goalsobjectives.php.

[2] *Asset Conservation, Lender Liability and Deposit Insurance Protection Act*, 1996, Pub. L. No. 104-208, 110 Stat. 3009.

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

[4] Securities Exchange Commission (SEC), ''Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies'' (SEC, January 31, 2003), 17 CFR Parts 239, 249, 270, and 274; Canadian Securities Administrators (2005).

[5] The scheme was revamped and extended in 2002 and 2005: *Regeling groenprojecten buitenland, Staatscourant* 1 (2 January, 2002) 31; *Regeling groenprojecten, Staatscourant* 131 (11 July, 2005) 13.

[6] Issued December 22 2005 pursuant to *Regulation on the Management of the Government Pension Fund*, 2004, at: http://odin.dep.no/fin/english/topics/pension_fund/p10002777/guidelines/bn.html.

[7] See http://www.foe.org/camps/intl/declaration.html.

[8] http://www.earthcharter.org.

[9] See, e.g., the cases of *Mandrake Management v. Toronto Transit Commission* (1993) 102 D.L.R. (4th); *Wheeler v. J.J. Saunders Ltd*, [1995] 3 W.L.R. 466.

[10] This fiduciary relationship is a concept of English law by which specific assets are held and managed by the trustee (i.e., the fiduciary) in the interests of the beneficiary (Hudson, 1999). Functionally similar legal arrangements in financial regulation tend to exist in civil law jurisdictions.

[11] [1985] 1 Ch. 270.

[12] *Martin v City of Edinburgh District Council* [1988] SLT 329; *Bishop of Oxford v Church Commissioners for England* [1992] 1 WLR 1241.

[13] Pension legislation often mandates priority to financial investment returns (e.g., US's *Employee Retirement Income Security Act* 1974, s. 404(a)(1)(D).

[14] Glover (1995, p. 50).

[15] Conn. Gen. Stat. (2002), s. 3-13d(a).

[16] *Trustee Act*, S.M. 1995, s. 79.1. In 2005, a similar provision was grafted into Manitoban pension legislation: *Pension Benefits Amendment Act*, S.M. 2005, s. 28.1(2.2).

[17] [2004] 3 S.C.R. 461, 2004 S.C.C. 68, para. 43.

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