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Complementary and Alternative Medicine: Opportunities and Challenges

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Socially Responsible Investing: Is Your Fiduciary Duty at Risk?

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ABSTRACT. Socially responsible investing identifies the fiduciary duty and liability for financial advisors serving individual and institutional clients when consulting in the SRI space. This article first discusses the role of a fiduciary emerging from both a legal and an ethical basis. Further, the special aspects of maintaining fiduciary duty and minimizing fiduciary liability are described as they relate to SRI. A number of recommendations are discussed: legal, ethical, and practice. This study argues that prudence focuses more on the process of decisions rather than their outcomes, as measured exclusively by rate of return.

KEY WORDS: advisor, fiduciary, fiduciary duty, fiduciary liability, investment advisor, socially responsible investing, ethical investing

Socially responsible investing (SRI) draws criticism from another fronts ranging from the violation of central tenets of Modern Portfolio Theory (MPT) (Markowitz, 1952) to a breach of fiduciary duty on the part of various stakeholders. Focusing on fiduciary duty, critics assert that to invest in SRI creates undue exposure to fiduciary liability because of many factors including violations of MPT, perceptions, and actual data that SRI financial performance is less than other investments, that the process of SRI investing is incompatible with other ways of investing, and that conflicts of interest arise that are unique to SRI.

The financial advisor landscape is radically changing with an increasing diversity of practitioners ranging from stockbrokers to certified financial planners (CFPs) and even an emerging group of professionals who identify themselves as wealth managers. These financial advisors are being compensated in a variety of ways including but not limited to compensation only, fee only, and assets under management. There is also an emerging area of practice focusing on socially responsible investing. SRI financial advisors offer their individual and institutional clients to invest beyond the single bottom-line and invest in assets that are designed to increase in financial value as well as benefit society in some fashion.

In the last few years, media attention has focused on corporate scandals in financial services, including mutual fund companies and other investment management organizations. For instance, UBS' global reputation was tarnished based upon allegations of the international private banking division "…helping a billionaire client evade taxes" (Simonian, 2008, p. 1). Even Societe Generale, the famed French bank, "…accused management of transforming the bank into a casino" (Bennhold, 2008, p. 11) based upon the trading debacles that occurred at the bank. As a result, in some nations like the United States, legislators passed bills like the Sarbanes-Oxley Act of 2002 to provide greater assurance to shareholders that boards, officers, and other agents of publicly traded companies will be held accountable for their conduct and any breaches in their duties and responsibilities. In addition to legislation seeking to inject professional accountability and public trust into the inner workings of companies, innovations in benefits along with the convergence of health and wealth products like Health Savings Accounts (HSAs) and an increasing reliance upon Voluntary Employee Benefits Associations (VEBAs) to fund health plans as in the case of the United Auto Workers and Big Three automakers are all advancing the role of the fiduciary. At the same time, this increase in corporate scandals has resulted in a growing demand for socially responsible investments (SRI; Boasson et al., 2004).

According to *2007 Report on Socially Responsible Investing Trends in the United States* published by the

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Social Investment Forum, "…SRI is thriving in the United States, growing at a faster pace than the broader universe of all investments under professional management" (p. 3). The increase in SRI rose from $639 billion in 1995 to $2.71 trillion in 2007 – a 324% gain (SIF, 2007). The $1.9 trillion in institutional assets was up 27% from 2006 (SIF, 2007). Also, the number of socially screened funds increased from 55 in 1995 to 260 in 2007 (SIF, 2007). Clearly, SRI is here to stay among all types of investors from retail to institutional.

It also appears that these corporate scandals are calling into question the fiduciary responsibility of financial advisors (Gibson, 2006). On March 30, 2007, The U.S. Court of Appeals for the District of Columbia Circuit ruled that the Securities and Exchange Commission (SEC) exceeded its authority in granting a 2005 disclosure exemption to brokers who provide investment advice that is incidental to their business, but who nonetheless are paid a special fee for the advice. This effectively eliminated the broker exemption created by that SEC rule. Brokers are also considered fiduciaries under the Employment Retirement Investment and Security Act (ERISA) when they provide investment advice for retirement plans. This court ruling and the interpretation that brokers are considered to be fiduciaries broadens the base of financial professionals who are considered to be fiduciaries.

Additionally, empirical research studies are calling into question the objectivity of financial advisors' ability to assess risk tolerance (Roszkowski and Grable, 2005). Furthermore, it has been argued that the ability to assess risk from a behavioral, attitudinal, and value point of view represents a fiduciary obligations for financial advisors (Davey, 2004). Boasson et al. (2004) further assert that it "…is the fiduciary duty of the investment managers to maximize returns at a reasonable level of risk for their clients" (p. 56) and the financial well-being of clients is in part dependent upon financial advisors. Financial advisors are operating increasingly under a microscope, and must take to heart their fiduciary responsibility.

Fiduciary liability is challenging in and of itself. But acting in a prudent fashion which is one of the hallmark elements of fiduciary duty may be even more vexing for those financial advisors who offer advice and counsel on socially responsible investments (SRI). This study will focus upon the interrelationships between fiduciary duty and SRI and builds upon the extant literature in this domain (Boasson et al., 2004).

This study will define the role of a fiduciary, trace the historical development of a fiduciary, describe fiduciary duties, and critically examine the nuances of being a fiduciary as it relates to socially responsible investing. It will highlight several recommendations for financial advisors to consider when acting in the role of a fiduciary for clients who pursue socially responsible investments.

This study builds upon the foundation established by Young (2007) in which he writes about the underlying moral constructs of fiduciary duty with regard to decision making. Also, Young (2007) writes, "[T]he challenge for business ethics is not so much enunciating the unyielding call of moral perfection but rather providing practical wisdom relevant to the needs of business decision-makers" (p. 1). The business decision makers addressed in this study are financial advisors realizing the impact that they have on the lives of their clients both institutional and retail.

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The role of a fiduciary?

A fiduciary is governed by legal rules, ethical guidelines, and behavioral standards. There are various definitions of a fiduciary emerging from such ethical codes as *Investment Management Consulting Association's Code of Professional Responsibility and Standards of Practice* and the *Certified Financial Planning Board's Code of Ethics and Professional Responsibility* and such statutes as the Employment Retirement Income Security Act (ERISA). ERISA defines a fiduciary as follows:

> Many of the actions involved in operating a plan make that person or entity performing them a fiduciary. Using discretion in administering and managing a plan or controlling the plan's assets makes that person a fiduciary to the extent of that discretion or control. Thus, fiduciary status is based on the *functions performed for the plan*, not just a person's title. (Department of Labor, 2004, p. 1)

It is essential that these core functions be identified to provide guidance for financial advisors.

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To date, there is no definitive source document which outlines the specific functions and duties of financial advisors. However, the *Standards of Practice* promulgated by The Investment Management Consulting Association and a recent study by Rattiner (2005) provide guidance on the many of the core duties of a financial advisor. Rattiner (2005) quotes Don Trone, AIF®, of the Center for Fiduciary Studies, to identify five situations in which a financial planner might act as a fiduciary. This could logically be extended to an financial advisor: (1) ''when the planner has discretion over a clients assets; (2) when the client is dependent on the planner's advice; (3) when the planner is providing a client with comprehensive and continuous investment advice; (4) when the planner is providing an ERISA client with investment advice, and is receiving a fee; and (5) when the planner is a registered investment adviser'' (Rattiner, 2005, pp. 39–40). These situations are more inclusive and broader than the ERISA definition and include those situations in which financial advisors work with individual clients.

The historical development of fiduciary duty

The current definition of a fiduciary, fiduciary duty, fiduciary liability, and prudence can be traced along two paths that began as far back as the Oath of Hippocrates. The two paths described in this study are the ethical basis and the legal/regulatory basis. Young (2007) traces the moral origins back to parable of the good shepherd who is a ''…fiduciary, an agent of the owner of the sheep who is responsible for the well-being of the flock'' (p. 2). This metaphor is extended in this study to include the investment professionals as the good shepherd and the flock as retail and institutional investors.

Ethical basis

The use of the term fiduciary dates back to David Hume's book 3 of *A Treatise of Human Nature* in the section ''Of Obligations of Promises'' published in 1739. Political economic scholars have referred to this section as Hume's fiduciary theory of money (Winnerland, 2001). In this treatise, Hume sets forth the need for some type of legal and/or ethical instrument to restrain human behavior, as illustrated by this passage from *A Treaties of Human Nature*: ''It follows, that fidelity is no natural virtue, and that promises have no force, antecedent to human convention'' (Hume, 1978, p. 518).

Fiduciary duty is not limited to financial advisors, but is part and parcel of what it means to be a member of any profession, from law to accounting to medicine. Darwish (2006) describes this duty from an ethical frame of reference in which the key issue is the ''trade-off between client interest and self-interest'' (p. 32). Olson (2003) argues that fiduciaries should act ''in the sole interest of the beneficiaries'' (p. xvii). Other commentators have noted that ''the nature of the fiduciary relationship is such that it is impossible for one to act as a fiduciary for multiple parties where the interests of those parties are (or are likely to be) in conflict'' (Marcoux, 2005, p. 4). This sentiment was echoed by Beardsen (2001) as illustrated in a case study of financial planners which found ''…both planners indicated they felt conflicts when working with friends or relatives, and this conflict had a negative impact upon the ability to provide high quality professional services'' (p. 27).

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Legal/regulatory basis

The early legal origins of fiduciary duty are to be found in English common law, and particularly the common law of trusts. The concept of the Prudent Man Rule arose from the landmark legal case *Harvard v. Amory*, 26 Mass. (9 Pick.) 446(1830) in 1830. This case turned on the question of whether trustees could invest in assets in stocks rather than government securities. The court ruled that trustees could invest not only in stocks, but also in those assets that met the unique needs and circumstances of the institution, so long as such trustees act in a prudent fashion. The court ruled that trustees should:

> observe how men of prudence, discretion, and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of the capital to be invested.

In 1942, the Model Prudent Man Investment Act was adopted by the American Bankers Association

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and later adopted by most states. The tension between conduct and performance continued until the passage of ERISA in 1974. It settled the debate: "the principle that conduct of the fiduciary and not investment performance should determine whether a fiduciary was to be considered prudent" (Boone, 2004, p. 19) became the law.

ERISA also changed the terminology from the Prudent Man Rule to "The Prudent Expert Rule." Under ERISA Section 404(a)(1)B, fiduciaries are required to act "with the care, skill, prudence, and diligence under the circumstances prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character with like aims." Prudence has been defined as focusing "on the process for making fiduciary decisions" (Department of Labor, 2004, p. 2). Again, the concept of a fiduciary is based more upon decision-making processes rather than the outcomes.

Hofman et al. (2007) discovered in an empirical study of 286 participants that the issue-contingent model of ethical decision making in organizations is applicable to SRI decision making. Young (2007) writes that a fiduciary "…is expected to assume new decision-making habits and reflective capacities that transcend selfishness" (p. 4). Given the recent credit crunch, subprime housing debacle, and even, oil speculators, the words of Young (2007) ring true in a more pronounced fashion.

There are two other noteworthy statutes at the federal level: the Uniform Prudent Investor Act (UPIA) and the Investment Advisers Act of 1940. The 1994 Uniform Prudent Investor Act (UPIA), which has now been adopted in 40 states, holds that trustees should carry out the following responsibilities.

1. A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distributions, requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution.
2. A trustee's investment and management decisions respecting individual assets must be evaluated not in isolation, but in the context of the trust portfolio as a whole and as part of an overall investment strategy, have risk and return objectives reasonably suited to the trust.

The UPIA primarily addresses the fiduciary responsibilities of trustees, but understanding their fiduciary duty has implications for financial advisors.

The Investment Advisers Act of 1940 does not explicitly state that advisors owe a fiduciary duty to their clients. However, this duty was expanded when the Supreme Court ruled in *SEC* v. *Capital Gains Research Bureau, Inc.* that the investment adviser serves as a *fiduciary* to its clients, though the term never appears in the act. Given the ethical and legal/regulatory basis of fiduciary duty, it is at this juncture that fiduciary duty and fiduciary liability will be further described.

Fiduciary duties/liabilities

Failing to meet fiduciary duty may result in exposure to liability. Accordingly, financial advisors must be keenly aware of the nature of fiduciary duty in order to provide optimal service for their clients in a way that places the interests of their clients first while simultaneously minimizing risk to the financial advisor. Fiduciary duty cuts both ways. First, failure to consider maximizing shareholder return regardless of the ethical and moral nature of the investments fits within the definition of fiduciary liability. Second, "…fiduciary duty to consider human rights, either present or emergent, its enforcement will depend on a mixture of laws and norms. In the post-regulatory world of the new governance, the question is less" (Williams and Conley, 2005, p. 104). This second view of fiduciary duty reflects "the post-regulatory world of new governance" (Williams and Conley, 2005, p. 104).

Nature of fiduciary duty

The ethical and legal/regulatory basis of fiduciary duty has been previously established. The second basis of fiduciary duty draws upon religion based upon scripture and doctrine. The third basis of fiduciary duty springs from professional duties. The religious and professional basis will be described below.

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Religious basis

The Judeo-Christian tradition highlights the scriptural and doctrinal basis of fiduciary duty (Young, 2007). Furthermore, it has been suggested that "…each fiduciary undertaking asserts a moral authority higher than self-interests of the appointed fiduciary" (Young, 2007, p. 4). Schwarz et al. (2007) postulate that certain Jewish principles can be used to develop a Jewish mutual fund.

Professional basis

Fiduciary duty arises out of professional duties, which are one of the hallmarks of a profession, as noted by Darr (2005) below:

> Professions are bound by the law but have a higher calling, one that includes numerous positive duties to patients [clients] and society and to one another." (p. 7)

Positive duties are a hallmark of any profession. Fear of fiduciary liability is laudable. However, professionals need to go beyond simply attempting to avoid direct harm and seek to promote the best interest of others.

Moreover, financial advisors should concern themselves not solely with the performance of specific investments, but with the process and practices utilized in the relationship with the client. This sentiment is reflected by experts who assert:

> Liability of the fiduciary is determined by whether prudent investment practices are followed, not by investment performance. Prudence is demonstrated by the process through which investment decisions are made, not by performance. (Ober, 2005, p. 50)

Nature of fiduciary liability

All fiduciaries are held to a standard of accountability if they are to carry out their duties and responsibilities in an expected fashion. For instance, as it relates to pension funds and investing, it is clear that financial advisors will increase their liability exposure if they fail to document "the process used to carry out their fiduciary responsibilities" (Department of Labor, 2004, p. 3). The nature of this particular type of fiduciary liability as it relates to ERISA plans extends to personal liability (Department of Labor, 2004). Documentation is vitally important to establish a record of enacting one's fiduciary duty and can serve as a defense if one's fiduciary duty is challenged.

Donald Trone of the Foundation for Fiduciary Studies (FFS) defines fiduciary liability as follows:

> Fiduciary liability is not determined by investment performance, but rather by whether prudent practices were followed. It's not whether you win or lose, it's how you play the game. A fiduciary demonstrates prudence by the process through which investment decisions are managed, rather than by showing the investment products and techniques are chosen because they were labeled as 'prudent.' (Trone and Allbright, 1996, p. 8)

Liability, particularly if personal, can increase anxiety and fear. Investment professionals and trustees are not immune (Merme, 2004). Merme describes this as the fear factor and demonstrates its relationship to short-termism:

> The fear factor for trustees, warned not to endanger the financial returns of the portfolios they are entrusted with, reinforces the industry's short-term financial benchmarking of performance. (Merme, 2004, p. 11)

This perspective is not novel and dates back to 1970, when Milton Friedman stated that profit maximization was the sole goal of corporate executives. However, Klaasen and Gay (2003) tell financial advisors not to be overly fearful of exposure to fiduciary liability even when recommending socially responsible investments:

> Experienced SRI advisors know it is possible to build diversified portfolios from the wide variety of SRI mutual funds, and to tailor them to each individual investor's financial and moral goals. They know the performance of SRI portfolios is comparable to that of non-SRI portfolios. And they know there is no need for any special conflict of interest – moral interests, in particular – between the SRI client and her advisor. In short, the most common reasons for refusing to pursue SRI are mistaken, and the fiduciary duties of an investment advisor may be met with socially responsible investments. (Klaasen and Gay, 2003, p. 49)

Financial advisors should be reminded of the Yerkes-Dodson curve. It states that the relationship

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between distress and performance, including cognitive functioning, is not linear, but curvilinear. If distress reaches a point beyond a certain level, then performance declines (Seaward, 2004). This affects the quality of decision making, which will also affect the ability to act in a prudent manner.

There are a few nuances when a financial advisor is working with pension and endowment funds and/or serving on fiduciary committees of such funds. It has been clearly established that the board of directors has ultimate, but not complete, responsibility for the management of such a fund (Olson, 2003). One researcher has concluded that socially responsible investing should not be the focal area of concern; rather, it should be the selection criteria and accountability of pension fund trustees (Sethi, 2005). Sethi (2005) also argues that traditional investment practices favor a short-term performance focus rather than a long-term focus, particularly as it relates to pension funds. Statman (2006) asserts that institutional investors may be under greater pressure to maximize returns due to the governance structure and fiduciary laws related to governance, including the Sarbanes-Oxley Act of 2002. Olson (2003) recommends that pension and/or endowment funds may invest in socially responsible investing, but advises such funds to use an imputed income method for recognizing income.

SRI and fiduciary duty: are the two inherently incompatible?

Two fundamental concerns face financial advisors who seek to maintain their fiduciary duty and invest in socially responsible investing on behalf of clients. The first concern relates to performance, which encompasses the risk/return relationship. The second concern relates to diversification. Both concerns can be allayed.

Performance

The central struggle facing all fiduciaries is "assessing return versus risk, not just risk itself" (Rattiner, 2005, p. 42). In assessing risk versus return, the issue of trading off performance for other perceived client returns should not haunt the financial advisor. Ober (2005) cautions against making the case that specific investments are inherently risky in terms of fiduciary liability:

> Even conservative and traditional investments may not measure up if a sound process is missing, while aggressive and unconventional investments that are arrived at by a sound process can meet the standard. (Ober, 2005, p. 50)

On the contrary, SRI critics in leading investment textbooks argue that socially responsible investing results in "a cost in the form of a lower reward-to-variability on the resultant constrained, optimal portfolio" (Bodie et al., 2005, p. 246). But financial experts are beginning to focus more on the risk of the total portfolio rather than a single asset class (Boone and Lubitz, 2004) based upon the tenets of Modern Portfolio Theory. As such, Modern Portfolio Theory is a cornerstone of UPIA.

The empirical evidence on the relative performance of socially responsible investing in comparison to conventional investing is not definitive. However, Statman (2000) discovered that social mutual funds perform no better or worse than conventional mutual funds. These findings were replicated by Bauer et al. (2002).

The performance of any investment can be based upon exceeding an absolute metric or a comparable metric. Waring and Siegel (2006) criticize the growing absolute-return investing trend, which argues that benchmarks do not matter. Benchmarks clearly have a role to play. This is similar to the cliché – compare apples to apples and oranges to oranges. Accordingly, the selection of the most appropriate benchmark is a key decision for any financial advisor. In essence, it can be reasonably argued that clients may prefer to focus on an absolute return, but relativity is key when assessing the performance of a particular investment, including socially responsible investments. The art is to prudently select a benchmark. Kuenzi (2003), citing the work of Bailey et al. (1990), as well as Bailey (1992), argues that an appropriate benchmark has the following characteristics: (1) "unambiguous, (2) investible, (3) measurable, (4) appropriate, (5) reflective of current investment opinions, and (6) specified in advance" (Kuenzi, 2003, p. 47).

In the SRI space, there are a number of appropriate benchmarks, including the Domini 400 Social

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Index (DS 400 Index), the Calvert Social Index, and the Dow Jones Sustainability Index. In a recent study, it was found that the DS 400 Index outperformed the S & P 500 Index from May 1990 to April 2004, although there were significant tracking errors (Statman, 2006). Statman (2006) offers two recommendations to address tracking errors: implement the best-in-class method and utilize optimization tools.

In Europe, there is a reported increase in the number of private bankers who are advising their clients on socially responsible investing. They consider the extra-financial investment criteria while at the same time remembering that: "Socially responsible investing is as reliant for its success on good performance as are other investment styles" (Koh, 2006, p. 1). In short, triple bottom-line investing does not ignore rate of return as a performance measure, but includes other measures that are important to serving the interests of clients.

Russoe and Schoemaker (2002) illustrate the central role of framing in the decision-making process. Framing has clear implications with respect to selecting appropriate SRI performance benchmarks, as well as determining if one is abdicating fiduciary duty when working with clients who choose to invest in SRI:

> Frames also influence our thinking through the yardsticks and reference points they lead us to adopt. How you measure your success or progress, for example, depends on your frame…Whatever yardsticks we use to measure performance, most contain a reference point or marker that distinguishes good from poor performance. Although reference points are often numerical, like a sales target or rate of return, they need not be. After all, not everything that is important can be measured. (Russoe and Schoemaker, 2002, p. 27)

Bossoe et al. (2004) argue based upon an empirical investigation of faith-based mutual funds that "…investment managers may incorporate moral/ethical components into their investment decisions without unduly shortchanging their clients for whom they have fiduciary duties" (p. 64).

Diversification

Beyond selecting an appropriate benchmark and framing, diversification is a tried and true method of managing investment risk. Bello (2005) discovered that "the effect of diversification on investment performance is no different" (Bello, 2005, p. 1) when comparing a sample of socially responsible stock mutual funds with a randomly selected sample of conventional mutual funds. Bello (2005) categorized performance using three distinct metrics: (1) portfolio beta; (2) degree of portfolio diversification; and (3) risk-adjusted investment performance. This empirical finding contradicts the work of Rudd (1981), who asserts that performance is compromised with any constraint imposed upon a portfolio. Brinson et al. (1991) found that about 95% of a portfolio's variability is attributed to asset allocation, not on the selection of individual securities. Moreover, Fridson (2006) argues that "the problem with SRI does not involve material underdiversification in securities holdings" (Fridson, 2006, p. 77). As such, the effect of SRI screening strategies should be minimal with regard to compromising diversification. Not only should the effect be minimal, but also it was empirically demonstrated by one researcher that "…the benefits of diversification can accrue to both traditional indexing investors who include social funds as part of their portfolio strategy, and to social investors who include some traditional funds or an index fund as part of their portfolios" (Hickman et al., 1999, p. 77).

It is generally recognized that diversification is one way of establishing prudence (Department of Labor, 2004). Some financial advisors fear that there are an insufficient number and heterogeneity of SRI assets in order to benefit from diversification, but this concern is unfounded. Morningstar Premium lists 260 socially conscious mutual funds, classified into the following categories: large value, large growth, mid-cap blend, moderate allocation, small growth, world stock, large blend, mid-cap growth, conservative allocation, small blend, small value, intermediate term bond, foreign large blend, and short-term bond. Of those 260 socially conscious funds, 15 earned Morningstar's five-star rating. Morningstar also lists four socially responsible index funds.

Hence, it is reasonable to conclude that socially responsible investing and fiduciary duty are not incompatible. In fact, this argument was put forth by Klaasen and Gay (2003) and further put forth by Trone et al. (1996), who highlighted the role of advisors and fiduciary duty as follows: "Simply stated,

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the role is to set policy, to select appropriate money managers (including mutual funds), and to monitor results'' (Trone et al., 1996, p. 2). Prudent SRI practices are based upon an investment policy statement (IPS), the selection of competent money managers, and the monitoring of performance against a valid benchmark rather than absolute return.

In short, financial advisors should adopt a disciplined approach when consulting with clients, focusing more on the core processes and key practices of investment management consulting rather than paying too much attention to absolute returns. Financial advisors should remind themselves that the outcomes of the work performed by professionals can rarely be controlled and guaranteed. The nature of professional work involves science, art, judgment, discretion, and decision making under conditions of uncertainty, risk, and perhaps even chaos.

In summary, based upon the evidence presented it can be argued that SRI is not incompatible with maintaining one's fiduciary duty. In fact, it can even be asserted that it is yet another way to demonstrate fiduciary duty. Also, even though SRI may violate the theoretical constructs of MPT, the empirical evidence is clear that SRI does not defacto result in lower financial performance. Moreover, one study found that SRI can even benefit a diversification strategy as explained by MPT (Hickman et al., 1999). A major theme throughout this study is that fiduciary duty arises out of attending to the investment process rather than narrowly focusing on financial return which is a factor that can be influenced but not controlled unlike process which is under the direct control of financial professionals and board members. It is the process that ought to be the focus of fiduciary duty not the returns. Accordingly, the remainder of this study attempts to highlight the key recommendations for SRI financial advisors to focus upon in order for them to better serve in their roles as fiduciaries.

Recommendations for financial advisors acting as fiduciaries when working with SRI clients

These specific recommendations will be organized into three distinct but related themes: legal, ethical, and practice.

Legal recommendations

Attention to legal compliance is the minimum for financial advisors seeking to fully embrace their fiduciary duties and responsibilities. Attending to legal/regulatory requirements necessitates that financial advisors also let their individual and institutional clients know about the laws and regulations that govern the profession and that seek to protect investors. In essence, transparency is a laudable goal for financial advisors.

Young (2007) establishes the legal basis of a fiduciary from the perspective of corporate directors but these tenets hold equally true for financial advisors as evidenced by the following legal duties imposed upon a fiduciary.

> Roughly speaking, a fiduciary is ordered by the law to act with self-restraint, with a view toward the advantage and interests of others. In this sense, the law imposes a duty on the person acting as a fiduciary. The fiduciary is ''other regarding.'' The duty of a fiduciary is to act with a view towards the well-being of others and not of self is divided into two areas of responsibility. The law speaks of 'duty of loyalty' and of 'duty of care.' (Young, 2007, p. 2)

Beyond these two affirmative duties which are grounded in the law, financial advisors are advised to seriously consider the ethical recommendations that follow.

Ethical recommendations

One of the best set of recommendations for financial advisors to adopt is based upon *A Handbook for Investment Fiduciaries* (2003–2005) published by The Center for Fiduciary Studies, which operates in association with the University of Pittsburgh, Joseph M. Katz Graduate School of Business, Center for Executive Education. The center also offers executive education and testing for those financial advisors who desire to earn the Accredited Investment Fiduciary (AIF) designation and the Accredited Investment Fiduciary Auditor (AIFA) designation. The handbook was published to address these issues among investment professionals:

> The Handbook will serve as a foundation for prudent investment fiduciary practices. It provides investment

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fiduciaries with an organized process for making informed and consistent decisions. Fiduciaries must, however, exercise professional judgment when applying the Practices; consulting legal counsel and other authorities when appropriate. (Center for Fiduciary Studies, 2003–2005, p. 3)

The handbook outlines 27 practices, seven Uniform Fiduciary Standards of Care, and a Five-Step Investment Management Process. These recommendations will focus upon the seven Uniform Fiduciary Standards of Care and a Five-Step Investment Management Process as a set of recommendations, with a particular focus on socially responsible investing.

As can be seen in Table I, the seven Uniform Fiduciary Standards of Care are meant to guide the role of the fiduciary. These seven Standards are based upon three statutes: ERISA, UPIA, and MPERS (Uniform Management of Public Employee Retirement Systems). Related to these seven Standards is the Five-Step Investment Management Process, shown in Table II. This recommended process provides the road map for financial advisors acting in fiduciary capacities to demonstrate prudence.

TABLE I

Uniform fiduciary standards of care

1. Know standards, laws, and trust provisions
2. Diversify assets to specific risk/return profile of client
3. Prepare investment policy statement
4. Use "prudent experts" (money managers) and document due diligence
5. Control and account for investment expenses
6. Monitor the activities of "prudent experts"
7. Avoid conflicts of interest and prohibited transactions

Source: Center for fiduciary studies (2003–2005).

TABLE II

Five-step investment management process

1. Step 1: Analyze current position
2. Step 2: Diversify-allocate portfolio
3. Step 3: Formalize investment policy
4. Step 4: Implement policy
5. Step 5: Monitor and supervise

Source: Center for fiduciary studies (2003–2005).

Among the 27 practices, the handbook lists four items that warrant the attention of financial advisors.

- Practice No. 3.5: The investment policy statement defines monitoring criteria for investment options and service vendors.
- Practice No. 3.7: The investment policy statement defines appropriately structured socially responsible investment strategies (when applicable).
- Practice No. 5.1: Periodic reports compare investment performance against an appropriate index, peer group, and IPS objectives.
- Practice No. 5.3: Control procedures are in place to periodically review policies for best execution, soft dollars, and proxy voting.

In the end, financial advisors who follow these 27 practices, seven Uniform Fiduciary Standards of Care, the Five-Step Investment Management Process, and understand their role as a fiduciary based upon the law, ethics, and codes of conduct should be in a better position to sleep well at night. They do not need to be overly concerned about forgoing their fiduciary duty and exposing themselves to fiduciary liability.

Another area of practice that deserves focused attention are Investment Policy Statements (IPS), which are a useful documented process of clarifying expectations and monitoring progress toward meeting specific expectations. The importance of an IPS cannot be underestimated. Yeske and Buie (2006) present a four-quadrant integral framework along with a six-step process to formulate policies designed to "embody the client's core values and goals as well as best practices of the profession" (Yeske and Buie, 2006, p. 51). The four quadrants are: individual/interior; individual/exterior; collective/interior; and collective/exterior. The consideration of SRI preferences and values of clients would fall into the individual/interior quadrant, which is described below:

> Who are you inside, your intentions, and how you feel about things, including attitudes toward spending and saving, personal risk tolerance, and your vision of the 'good life.' (Yeske and Buie, 2006, p. 51)

The six-step process to formulate policies consists of the following six steps: (1) discovery; (2) identify

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798 planning areas and related principles; (3) combine
799 client goals/attitudes with planning principles; (4)
800 test policies and develop specific recommendations;
801 (5) test policies with clients, and (6) periodic review
802 and update (Yeske and Buie, 2006). This model and
803 accompanying process are applicable to SRI.

804 *Client engagement recommendations*

805 Increasingly, institutional investors like pension
806 funds and colleges and universities are adopting SRI
807 guidelines.

808 **Conclusion**

809 Socially responsible investing is slowly become
810 increasingly mainstream. This makes it even more
811 critical to establish the fiduciary duties of financial
812 advisors to their clients. On a global level, the profit
813 maximization goal of investors is being challenged.
814 For some clients, profit maximization may be just
815 one goal to seek in combination with other goals and
816 interests. One commentator fully captured the spirit
817 of this view in reviewing his career as an investment
818 professional:

819 We can succeed as a profession only by placing client
820 interests above all else. Investment management is
821 about service and integrity. We cannot forget either.
822 (Carr, 2005, p. 79)
823

824 SRI financial advisors and their clients deserve to
825 experience the highest quality of service and
826 expertise, as captured by one of the respondents
827 to the IMCA Monitor Editorial Board survey on
828 ethical practices:

829 Trust is built initially by taking time to understand
830 what is important to clients and by showing them the
831 processes behind portfolio management. By revealing
832 the strategies used to help them accomplish their goals,
833 we build the trust further. Ultimately, the trust is
834 solidified by giving the client realistic expectations and
835 executing the processes as described. (IMCA Monitor,
836 2005, p. 17)
837

838 The title of this article – *Socially Responsible*
839 *Investing: Is Your Fiduciary Duty at Risk*? – is a critical
840 question for all financial advisors and the clients
841 whom they serve. The evidence presented in this
842 study would conclude that your fiduciary duty is not
843 risk. This article seeks to respond to the challenge set
844 forth by Young as illustrated below:

845 The challenge for business ethics is not so much
846 enunciating the unyielding call of moral perfection but
847 rather providing practical wisdom relevant to the
848 needs of business decision-makers. (Young, 2007, p. 1)
849

850 Financial advisors who specialize in socially
851 responsible investing do not have to provide less
852 service or act in a fashion that demonstrates less
853 integrity. However, such advisers should inform
854 prospective clients of this specialty and spell out any
855 inherent risks as matter of fair disclosure and fully
856 inform the client. Socially responsible investing,
857 investment management consulting, prudence, and
858 fiduciary responsibility can interact well together.
859 The task is not easy. But neither is it impossible.

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