

ESG INVESTMENT AND REFORMING THE FIDUCIARY DUTY

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I. INTRODUCTION

The ESG-based investment is becoming an integral part of financial accounting in the corporate world, fueled by concerns over climate change, oil spills, and corporate misconducts. ESG investment is an umbrella term for an investment strategy that emphasizes the corporate governance structure or the environmental or social impact of a company's products and practices.¹ The term "ESG" (Environmental, Social and Governance)² is currently used by institutional investors and investment professionals not only to implement sustainability measures and environmental, social and governance practices, but also specifically to refer to all nonfinancial fundamentals affecting a company's financial performance.³

In 2005, the United Nations Environment Programme Finance Initiative (UNEP-FI) announced a legal framework for the integration of environmental, social, and governance issues into institutional investment. Institutional investors, which are signatories to the United Nations Principles for Responsible Investment ("PRI"), promise to be "active owners," taking into account "the relevance to the investor of [ESG] factors, and the long-term health and stability of the market as a whole....in order to allocate

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¹ See Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments, 80 Fed. Reg. 65,135 (Oct. 26, 2015) (noting that ESG and related "terms do not have a uniform meaning and the terminology is evolving").

² Environmental factors include climate change, carbon emissions, pollution, energy efficiency, waste management, biodiversity, deforestation, and water use related to water scarcity. Social factors include labor conditions, employee engagement, human rights, gender and diversity policies, and community relations. Governance factors include diversity on the board, executive compensation, audits and transparency for shareholders and other stakeholders, corruption policies, lobbying activities, and political contributions.

³ Max Schanzenbach & Robert Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 STAN. L. REV. 381, 388 (2020).

capital in a manner that is aligned with the short and long-term interests of their clients and beneficiaries.”⁴ Especially after the global financial crisis of 2008–2009, the demand for sustainable investment has increased rapidly. As of November 2019, more than 1,900 asset managers have signed the PRI’s statement of principles on ESG investment, including many of the world’s leading institutional investors.⁵ Global sustainable investment, including ESG investment, exceeded \$30 trillion by 2018, up 34% from 2016.⁶ In the United States, sustainable investments reached \$12 trillion by the beginning of 2018, according to a report from the US SIF Foundation.⁷ That’s one-quarter of the total \$46.6 trillion U.S. assets under professional control.⁸

Most institutional investors have recently included the ESG risks and opportunities in the investment decisions.⁹ In January 2018, BlackRock Chairman and CEO Larry Fink said in a letter to the CEO that the board of directors seeking support from leading investment firms have to prioritize ESG issues, as well as promote board diversity and clarify long-term strategies.¹⁰ In addition, the Business Roundtable announced the adoption of a new statement on the purpose of a corporation, signed by 181 prominent and high-powered CEOs, in a press release issued in August 2019.

The statement explicitly states “moves away from shareholder primacy” as a guiding principle and instead outlined a “modern standard for corporate

⁴ U.N. PRINCIPLES FOR RESPONSIBLE INV., *What are the Principles for Responsible Investment?*, <https://www.unpri.org/pri/what-are-the-principles-for-responsible-investment> [<https://perma.cc/HT2N-5YUS>].

⁵ See *Principles for Responsible Inv.*, SIGNATORY DIRECTORY (Updated Nov. 2019), [<https://perma.cc/R66R-72LU>]. Most signatories (1,033) are European; the second largest group is from North America (508).

⁶ GLOB. SUSTAINABLE INV. ALL., *The Global Sustainable Investment Review 2018* (2019), http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf [<https://perma.cc/89CB-AK9R>].

⁷ US SIF: THE FORUM FOR SUSTAINABLE AND RESPONSIBLE INVESTMENT, *Report on US Sustainable, Responsible and Impact Investing Trends*, (Oct. 31, 2018) <https://www.ussif.org/files/Trends/Trends%202018%20executive%20summary%20FINAL.pdf> [<https://perma.cc/398M-3UKN>].

⁸ Jacob Fonseca, *The Rise Of ESG Investing: How Aggressive Tax Avoidance Affects Corporate Governance & ESG Analysis*, 25 ILL. BUS. L.J. 1, 7 (2020).

⁹ See Jackie Cook & Jon Hale, *2019 ESG Proxy Voting Trends by 50 U.S. Fund Families*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 23, 2020) <https://corpgov.law.harvard.edu/2020/03/23/2019-esg-proxy-voting-trends-by-50-u-s-fund-families/> [<https://perma.cc/EVE3-LFKP>].

¹⁰ See letter from Lawrence D. Fink, Chairman/CEO, Black Rock (Jan. 12, 2018) <http://www.wlrk.com/files/2018/BLKCEOLetter2018.pdf> [<https://perma.cc/4QJV-BLK7>] (describing that for long-term prosperity, every company must not only deliver financial performance, but also show a positive contribution to society, and that companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities.).

responsibility” which makes a commitment to all stakeholders,¹¹ and incorporated one of the ESG concepts. Under the Statement of Purpose, each signatory commits to delivering value to its customers, investing in its employees, dealing fairly and ethically with its suppliers, supporting the communities in which it works, and generating long-term shareholder value.

In response to changing investment climates, the new 2020 UK Stewardship Code, issued by the FRC, defines stewardship as “the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.” The 2020 code is currently read somehow as an ESG code. Principle 4 thereof not only recognizes climate change as a systemic risk that investor signers need to take into account, but also explains how it worked with other stakeholders in promoting well-functioning markets. This context is consistent with the 2019 U.S. Business Roundtable announcement on the true purpose of companies.

Prior to the PRI, an influential 2005 report, sponsored by the United Nations Working Group, prepared by the international law firm Freshfields Bruckhaus Deringer, analyzes fiduciary duty applied to investment decision-making and concludes that the integration of the ESG considerations into investment analysis is “clearly permissible” and “arguably required.”¹²

However, 22% of investment professionals who do not consider ESG factors reported that they would do so if it would not conflict with the fiduciary constraints.¹³

This is where fiduciary duty issues arise. Under the Restatement (Third) of Trusts, the fiduciary duty imposed on institutional investors under the trust law requires a trustee to act “as a prudent investor would.”¹⁴ In addition, a trustee’s fiduciary duty requires loyalty. In the case of a private pension, The Employee Retirement Income Security Act of 1974 (ERISA) manages a private defined benefit pension plan¹⁵ and imposes fiduciary duty on the

¹¹ See Martin Lipton, *Stakeholder Corporate Governance Business Roundtable and Council of Institutional Investors*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 21, 2019), <https://corpgov.law.harvard.edu/2019/08/21/stakeholder-corporate-governance-business-roundtable-and-council-of-institutional-investors/> [<https://perma.cc/UDS2-4JQB>].

¹² UNEP FIN. INITIATIVE, *A Legal Framework For The Integration Of Environmental, Social And Governance Issues Into Institutional Investment* 13 (2005), [<https://perma.cc/UBZ3-WUG8>] (concluding that the links between ESG factors and financial performance are increasingly being recognized, and that on that basis, integrating ESG considerations into an investment analysis for a more reliable prediction of financial performance is clearly permissible and is arguably required in all jurisdictions.).

¹³ CFA INST., *Environmental, Social, And Governance Issues In Investing: A Guide For Investment Professionals* 33 (2015), [<https://perma.cc/GU5Q-8L7A>].

¹⁴ See RESTATEMENT (THIRD) OF TRUSTS § 90 (AM. L. INST. 2007).

¹⁵ See Anne M. Tucker, *Retirement Revolution: Unmitigated Risks in the Defined Contribution Society*, 51 HOUSTON L. REV. 153, 164–65 (2013).

investment of the assets.¹⁶ In addition, the fiduciary must act in the best interests of the beneficiary, without any undisclosed, unmitigated conflicts of interest or self-dealing.¹⁷ ERISA regulations change common law prudent investor standard by imposing a high standard on the duty of loyalty that do not allow conflicts of interest dealings,¹⁸ even if otherwise profitable.¹⁹ Under the sole interest rule of trust fiduciary law, which exceeds the best interest rule, the trustee must consider only the interests of the beneficiary. Therefore, a trustee's use of the ESG factors violates the duty of loyalty if it is motivated by the trustee's own ethics or used to obtain collateral benefits for a third party.

The question is whether the sole interest rule's severity is based on outdated assumptions.²⁰ Prudent transactions to promote the beneficiaries' best interests best serve the purpose of their duty of loyalty, even if the trustee gains or may gain some profit. Langbein recommends revising the trust law duty of loyalty; the trustee must act in the best interests of the beneficiary, but not necessarily in the sole interests of the beneficiary.²¹

To achieve this aim, this Article proceeds as follows. Part II describes that ESG consideration does not require additional costs to investment strategies in accordance with some meta-study.

Part III describes the framework of fiduciary duty including the duty of loyalty, the prudent investor rule and the duty of impartiality. In particular, the duty of loyalty that is the essential point of this article is analyzed under the Restatement of Trusts and ERISA, and further discussed with respect to application of the duty of loyalty to ESG investment. In the middle of discussion, the distinction in the rules of application of the sole interest rule and the best interest rule is argued based on the current judicial and scholarly status of the discussion. In Part IV, I propose adoption of the best interest rule instead of the sole interest rule that is somewhat outdated and strictly severe, which proposal is supported by various reasons. ESG information is now disclosed voluntarily but should be standardized for more effective usage of such information. Part V presents such efforts in the U.S. Finally, Part VI sets

¹⁶ See generally *id.* at 163–76 (discussing the distinctions between defined benefit and defined contribution plans).

¹⁷ *Id.* at 195.

¹⁸ U.S. DEP'T OF LAB., *ERISA Fiduciary Advisor*, <https://webapps.dol.gov/elaws/ebsa/fiduciary/q4d.htm> [<https://perma.cc/YRE3-486E>](stating that the parties that are prohibited from doing business with the plan are referred to as “parties-in-interest,” which includes the employer, the union, plan fiduciaries, service providers, and statutorily defined owners, officers, and relatives of parties-in-interest).

¹⁹ See RESTATEMENT (THIRD) OF TRUSTS § 90 (AM. L. INST. 2007) (“Heavy emphasis in the regulations on the duty of loyalty and prohibited transactions (even for otherwise prudent, profitable investments) is understandable in this context.”).

²⁰ John H. Langbein, *Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest*, 114 YALE L.J. 929 (2005).

²¹ See *infra* part IV.

out concluding remarks.

II. NO ADDITIONAL COSTS BY ESG CONSIDERATION

The concern that SRI requires costs because of its imposition of limits on diversification continues to influence people's thinking about investment strategies that sound like SRI.²² This concern is caused, at least in part, by the confusion over the definition of SRI and the inaccuracy of terms that describe various investment strategies.²³ A study comparing SRI and non-SRI funds found that most SRI funds had positive or neutral results. While some studies showing negative results for SRI funds focus on negative screens,²⁴ no studies support the conclusion that any form of SRI will necessarily result in low risk-adjusted returns.²⁵

Researchers are wondering if investing in a sustainability initiative will increase the cost of the company and bring it a competitive disadvantage. Researchers have found that highly sustainable companies outperform less sustainable ones in both stock market and accounting performance.²⁶ Released in March 2015, the meta-study found an overall positive economic impact for companies incorporating sustainability practices. The report states that paying attention to ESG issues can mitigate both company-specific risks and external costs.

Research shows that a strategy using ESG factors as part of a robust financial analysis (a strategy called "ESG integration") does not incur the required cost of the portfolio when compared to a non-ESG portfolio.²⁷ ESG integration may even improve risk-adjusted returns, especially over a longer

²² See ROBERT G. ECCLES & MIRTHA D. KASTRAPELI, *THE INVESTING ENLIGHTENMENT: HOW PRINCIPLE AND PRAGMATISM CAN CREATE SUSTAINABLE VALUE THROUGH ESG* (2017),

http://www.statestreet.com/content/dam/statestreet/documents/Articles/The_Investing_Enlightenment.pdf [<https://perma.cc/GB53-ZM8H>].

²³ Such strategies including negative screens, ESG integration, and impact investing all operate quite differently, but they sometimes get lumped together as "social investing," "responsible investing," "ESG investing," or even "impact investing."

²⁴ See U.N. ENV'T. PROG. FIN. INITIATIVE, ASSET MGMT. WORKING GRP. & MERCER, *DEMISTIFYING RESPONSIBLE INVESTMENT PERFORMANCE* (2007), http://www.unepfi.org/fileadmin/documents/Demystifying_Responsible_Investment_Performance_01.pdf [<https://perma.cc/B22K-JXX4>] (reviewing 20 peer-reviewed academic studies of the effect of ESG factors on portfolio performance, half of which found a positive effect, seven a neutral effect, and three a negative effect).

²⁵ Gunnar Friede et al., *ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies*, 5 J. SUSTAINABLE FIN. & INV. 210 (2015) (reviewing over 2,000 primary studies by examining prior review studies).

²⁶ *Id.* at 226.

²⁷ See Susan N. Gary, *Best Interests in the Long Term: Fiduciary Duties and ESG Integration*, 90 U. COLO. L. REV. 731 (2019).

period of time.²⁸ The duty of loyalty will not be compromised by a discretion to invest using strategies that incorporate ESG criteria, even if the duty of loyalty is defined as the duty to act solely on the financial interests of the beneficiary, unless the strategy involves sacrificing financial returns.

III. FRAMEWORK OF FIDUCIARY DUTY

A fiduciary has to treat beneficiaries of all generations impartially, act in the best interests of the beneficiaries, not in the interests of the fiduciary, and follow prudent investor standards in investing in the assets of a company. These three duties are interrelated, especially for long-term trusts, pension plans, and endowments.²⁹ In the Restatement (Third) of Trusts, the fiduciary duty imposed on institutional investors under the trust law requires a trustee to act “as a prudent investor would.”³⁰ “This standard requires the exercise of reasonable care, skill, and caution, and is to be applied to investments not in isolation but in the context of the trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust.”³¹ The restatement discusses social investment, but does not provide clear guidance on whether it is consistent with the trustee’s duty of the fiduciary.³² The prudent investor rule stated in the Restatement incorporates modern portfolio theory by focusing on the overall portfolio.³³ Practical application of this theory requires widespread investment diversification.

A fiduciary must adhere to “prudent man standard of care.” In other words, it must “discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries.”³⁴ ERISA and subsequent case law provide parameters that define the required, permitted and prohibited fiduciary behaviors. The prudent man standard, as defined in ERISA § 404(a)(1) and U.S.C. § 1104(a)(1), requires that fiduciaries act:

(A) for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries; and (ii) defraying

²⁸ *Id.* at 746.

²⁹ For author’s previous paper concerning institutional investors’ fiduciary duties, see Akio Otsuka, *For Institutional Investors, the Alternative of “Exit or Voice,” or “Empowerment or Engagement” in the United States and the United Kingdom*, 2 INT’L COMP. POL’Y & ETHICS L. REV. 674, 706–07 (2019).

³⁰ See RESTATEMENT (THIRD) OF TRUSTS § 90 (AM. L. INST. 2007).

³¹ *Id.* at § 90(a). In addition, trustees’ fiduciary duties include loyalty and impartiality to beneficiaries, diversification of investments, and prudence in delegating responsibilities and paying attention to reasonable costs. See *id.* §§ 90(b)–(c).

³² See David Hess, *Public Pensions and the Promise of Shareholder Activism for the Next Frontier of Corporate Governance: Sustainable Economic Development*, 2 VA. L. & BUS. REV. 221, 248 (2007); RESTATEMENT (THIRD) OF TRUSTS § 90 (AM. L. INST. 2007).

³³ RESTATEMENT (THIRD) OF TRUSTS § 90(A) (AM. L. INST. 2007).

³⁴ 29 U.S.C. § 1104(a)(1).

reasonable expenses of administering the plan; (B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims; (C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and (D) in accordance with the documents and instruments governing the plan [insofar as such documents and instruments are consistent with the provisions of this subchapter and subchapter III.]³⁵

A. *Duty of Loyalty*

There are two types of the duty of loyalty. The first is the “sole interest” rule in which the trustee must “administer the trust solely in the interest of the beneficiaries.”³⁶ Under this rule, “the trustee has a duty to the beneficiaries not to be influenced by the interest of any third person or by motives other than the accomplishment of the purposes of the trust.”³⁷ Acting with mixed motives causes “an irrebuttable presumption of wrongdoing.”³⁸ If a trustee has a motive to take an action other than for the beneficiary’s “sole interest,” even in the absence of self-dealing, then under the sole interest rule, the trustee violates the duty of loyalty.³⁹ Then, it is sufficient for a beneficiary to prove the violation by proving the fact of such mixed motives.⁴⁰ The sole interest rule is mandatory under ERISA and is a default rule under trust law. The other type of the duty of loyalty is the “best interest” rule. Under this concept of loyalty, which is typical of company law and applies under trust law if the sole interest rule is waived, a fiduciary is not categorically prohibited from acting involving a conflict of interest, but rather must act in the best interest of the principal despite the conflict. The sole interest rule does not allow any defense against unauthorized conflicts at all, but the best interest rule allows a fiduciary to defend a conflicted action

³⁵ Ashley C. Vicere, *Defining “Fiduciary”: Aligning Obligations With Expectations*, 82 BROOK. L. REV. 1783, 1788 (2017).

³⁶ RESTATEMENT (THIRD) OF TRUSTS § 78(1) (AM. L. INST. 2007); *see also* UNIF. TR. CODE § 802(a) (UNIF. L. COMM’N 2010).

³⁷ RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. f (AM. L. INST. 2007).

³⁸ Daniel R. Fischel & John H. Langbein, *ERISA’s Fundamental Contradiction: The Exclusive Benefit Rule*, 55 U. CHI. L. REV. 1105, 1114–15 (1988).

³⁹ Schanzenbach & Sitkoff, *supra* note 3, at 401.

⁴⁰ *But see* Evan J. Criddle, *Liberty in Loyalty: A Republican Theory of Fiduciary Law*, 95 TEX. L. REV. 993, 1033, 1046–47 (2017) (describing conditions where “a fiduciary’s motivations for loyal or disloyal behavior are legally and practically irrelevant,” and concluding “[f]rom the perspective of republican legal theory, therefore, the better view is that fiduciary loyalty is concerned with a fiduciary’s actions and intentions, not her motivations.”).

as completely fair.⁴¹

1. *Restatement of Trust (Other than ERISA)*

Historically, the duty of loyalty required the trustee to “administer the trust solely in the interest of the beneficiary.” The First, Second, and Third Restatements of Trusts clarify that the main purpose of the duty of loyalty is to prevent conflicts of interest between trustees and beneficiaries.⁴² It was not created to prioritize the interests of participants and beneficiaries in maximizing returns to the fund over those of other participants and beneficiaries of the fund.⁴³ According to the Restatements, trustees should not profit at the expense of beneficiaries.⁴⁴ In other words, the duty of loyalty has always been aimed at preventing the frequent and immense temptations of fiduciaries to exercise their power for their own interests, not for the beneficiaries of the trust.⁴⁵ This prejudice is central to the duty of loyalty, and even transactions that are shown to be harmless to the beneficiaries are prohibited due to the slippery slopes that are created for the fiduciary.⁴⁶ As explained in the Restatement (Third) of Trusts, “[a] trustee may be authorized by the terms of the trust, expressly or by implication, to engage in transactions that would otherwise be prohibited by the rules of undivided loyalty.”⁴⁷ The best interests, not the sole interests for the duty of loyalty apply in such situations.⁴⁸

2. *ERISA*

ERISA codified the traditional fiduciary duty of trust law, including the duty of loyalty and prudence.⁴⁹ Under the traditional duty of loyalty, fiduciaries are required to “discharge their responsibilities with exclusive

⁴¹ Schanzenbach & Sitkoff, *supra* note 3, at 402.

⁴² RESTATEMENT (FIRST) OF TRUSTS § 170 cmt. (Am. L. Inst. 1935); *accord* RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. a,b (Am. L. Inst. 2007); RESTATEMENT (SECOND) OF TRUSTS § 170 cmt. a (Am. Law Inst. 1959).

⁴³ *Id.*

⁴⁴ RESTATEMENT (FIRST) OF TRUSTS § 170 cmt. a (Am. L. Inst. 1935); RESTATEMENT (SECOND) OF TRUSTS § 170 cmt. a (Am. L. Inst. 1959).

⁴⁵ See TAMAR FRANKEL, FIDUCIARY LAW 108 (2011) (describing “fiduciaries [must] act for the sole benefit of the entrustors [P]reventive rules act to dampen the fiduciaries’ temptations to misappropriate entrusted property or power, or to justify benefitting themselves, and establish a continuous reminder that entrusted property or power do not belong to the fiduciaries.”).

⁴⁶ See generally John H. Langbein & Richard Posner, *Social Investing and the Law of Trusts*, 79 MICH. L. REV. 72, 96–99 (1980).

⁴⁷ RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. c(2) (Am. L. Inst. 2007).

⁴⁸ Schanzenbach & Sitkoff, *supra* note 3, at 414–15.

⁴⁹ See 29 U.S.C. § 1103(c)(1) (imposing duty of loyalty); see 29 U.S.C. § 1104(a)(1)(B) (imposing duty of prudence).

concern for the welfare of their beneficiaries.”⁵⁰ This duty is included in ERISA sections 403 and 404. Section 403 provides: “assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries.”⁵¹ Section 404 establishes the sole interest rule by requiring pension trustees to act “solely in the interest of the participants and beneficiaries” and for the “exclusive purpose” of “providing benefits” to them.⁵²

In addition, the duty of care under ERISA requires specialized skills, setting the scope of reasonableness from those “acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.”⁵³ A reporter’s note on section 90 of the Restatement distinguishes ERISA and admits “an interpretation [of ERISA] that imposes a standard of skill in investment management different from that imposed by general trust law.”⁵⁴ As such, ERISA regulations change common law’s prudent investor standard.

Moreover, in providing benefits under ERISA, the Supreme Court held that the purpose to which ERISA’s sole interest rule applies is “financial benefits” to the beneficiaries of the plan. Therefore, under Supreme Court precedent, a pension trustee violates the duty of loyalty whenever the trustee acts for any purpose other than providing financial benefits to the beneficiaries. Acting under other motives is a breach of the duty of loyalty, even without direct self-dealing.⁵⁵ Even if the trustee’s motives are mixed to seek both providing financial benefits to the beneficiaries and obtaining collateral benefits, the trustee violates the sole interest rule.⁵⁶ Based on the Supreme Court’s current ERISA interpretation, pension trustees may not consider collateral benefits in any investment decision.⁵⁷

3. *Application of Duty of Loyalty to ESG Investment*

Recently, Schanzenbach and Sitkoff differentiated “collateral benefits” ESG from “risk-return” ESG and analyzed them under trust fiduciary law.

⁵⁰ See Edward A. Zelinsky, *Interpretive Bulletin 08-1 and Economically Targeted Investing: A Missed Opportunity*, 82 S. CAL. L. REV. POSTSCRIPT 11, 12 (2009) (citing RESTATEMENT (THIRD) OF TRUSTS § 78 (Am. Law Inst. 2007)).

⁵¹ 29 U.S.C. § 1103(c)(1) (codifying Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, § 403(c)(1), 88 Stat. 829 (1974)).

⁵² Employee Retirement Income Security Act of 1974 § 404(a)(1)(A)(i) (codified as amended at 29 U.S.C. § 1104(a)(1)(A)(i)). Consistent with ordinary trust law, see RESTATEMENT (THIRD) OF TRUSTS § 78 (Am. L. Inst. 2007). ERISA also allows for “defraying reasonable expenses of administering the plan.” ERISA § 404(a)(1)(A)(ii) (codified as amended at 29 U.S.C. § 1104(a)(1)(A)(ii)).

⁵³ 29 U.S.C. § 1104(a)(1)(B). Compare with RESTATEMENT (THIRD) OF TRUSTS § 90(a).

⁵⁴ RESTATEMENT (THIRD) OF TRUSTS § 90.

⁵⁵ Schanzenbach & Sitkoff, *supra* note 3, at 403–04.

⁵⁶ *Id.* at 405.

⁵⁷ See *id.* at notes 110–12 and accompanying text.

They refer to ESG investments motivated by providing benefits to a third party or otherwise for moral or ethical reasons as “collateral benefits ESG,” and ESG investment motivated to improve risk-adjusted returns as “risk-return ESG.” Investor motives make a difference.⁵⁸ Motives for moral or ethical reasons violate the duty of loyalty under the trust law fiduciary duty which imposes the sole interest rule requiring a fiduciary to consider only beneficiary’s interests, not the interests of anyone else, whether the fiduciary or a third party.⁵⁹ In contrast to collateral benefits ESG, risk-return ESG may be consistent with the duty of loyalty under ERISA, if the trustee’s “sole” or “exclusive” motive is to provide benefits to the beneficiary by improved risk-adjusted returns.⁶⁰ Motivated solely for this purpose, the risk-return ESG investment strategy meets the sole interest rule under the duty of loyalty, even under the Supreme Court’s strict “financial benefits” interpretation under ERISA.⁶¹ The duty of loyalty prohibits collateral benefits ESG as a mandatory rule under ERISA and as a default rule in charities and personal trusts.⁶²

For example, a collateral benefits ESG investment strategy may avoid investing in fossil fuel companies because of the collateral benefits of reducing pollution. In contrast, risk-return ESG investment involves using ESG factors as indicators to assess expected risk and return, with the goal of improved returns with low-risk. For example, a fossil fuel company’s risk-return ESG analysis may conclude that the company’s litigation risk and regulatory risk are undervalued by its stock price, and that reducing or avoiding investment in the company will improve its risk-adjusted return.⁶³

According to Schanzenbach and Sitkoff, the adequacy of the risk-return ESG is based on the claim that it can provide superior risk-adjusted returns.⁶⁴ Furthermore, there are no exceptions to the sole interest rule for pension trustees covered by the federal pension law, but trustees of personal trusts may consider third-party benefits on the conditions of a settlor’s authorization of the trust terms or a beneficiary’s consent or release.⁶⁵ Therefore, the settlor may, by the trust terms, authorize the trustee to have mixed motives in the form of considering the collateral benefits from ESG factors in investing in the trust property. With such authorization, consideration of collateral benefits from ESG factors does not itself constitute a *per se* breach of the duty of loyalty.⁶⁶

The US Department of Labor’s view of ESG investment by pension trustees has been documented in various bulletins over the years. The

⁵⁸ *Id.* at 397.

⁵⁹ *See id.* at Part II.A.

⁶⁰ *Id.* at 406.

⁶¹ *See id.* at 404 nn.111–12.

⁶² *Id.* at 453.

⁶³ *Id.* at 398.

⁶⁴ *See id.* at 433–48.

⁶⁵ *See id.* at 414–20.

⁶⁶ *Id.* at 415.

wording of the 2008 bulletin has raised concerns that strategies that take ESG factors into account are inadequate.⁶⁷ The 2015 Interpretive Bulletin published by the Department of Labor reflects the understanding that ESG integration may provide better financial results than other investment strategies, and a prudent investor may consider ESG factors.⁶⁸ Moreover, the Department of Labor states that the trustee may consider such factors in its risk-return framework, because a pension trustee should appropriately consider factors that potentially influence risk and return, and because environmental, social, and governance issues may have a direct relationship to the economic value of the plan's investment.⁶⁹ According to said bulletin, "[i]n these instances, such issues are not merely collateral considerations or tie-breakers, but rather are proper components of the fiduciary's primary analysis of the economic merits of competing investment choices."⁷⁰ In the bulletin, furthermore, the Department of Labor reaffirmed that it had consistently stated that "the focus of plan fiduciaries on the plan's financial returns and risk to beneficiaries must be paramount" and that "ERISA do[es] not permit fiduciaries to sacrifice the economic interests of plan participants in receiving their promised benefits in order to promote collateral goals."⁷¹

In the 2018 field assistance bulletin, the Department of Labor added "plan fiduciaries are not permitted to sacrifice investment return or take on additional investment risk as a means of using plan investments to promote collateral social policy goals."⁷² The bulletin also reiterated the Department of Labor's "longstanding view . . . that when competing investments serve the plan's economic interests equally well, plan fiduciaries can use such

⁶⁷ Interpretive Bulletin Relating to Investing in Economically Targeted Investments, 73 Fed. Reg. 61,734 (Oct. 17, 2008); Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments, 80 Fed. Reg. 65,135 at 65,136 (Oct. 26, 2015) (codified at 29 C.F.R. § 2509) (stating that "consideration of collateral, non-economic factors" in investment decision-making should be rare and well documented. I.B. 2015-01 explained that the Department of Labor had become concerned "that the 2008 guidance may be dissuading fiduciaries from (1) pursuing investment strategies that consider environmental, social, and governance factors, even where they are used solely to evaluate the economic benefits of investments and identify economically superior investments, and (2) investing in ETIs even where economically equivalent.").

⁶⁸ Interpretive Bulletin, 80 Fed. Reg. at 65,135.

⁶⁹ *Id.* (explaining that "plan fiduciaries may invest in ETIs based, in part, on their collateral benefits so long as the investment is economically equivalent, with respect to return and risk to beneficiaries in the appropriate time horizon, to investments without such collateral benefits."). ETIs (Economically Targeted Investments) are investments that generate collateral benefits for communities apart from the investment return to the plan.

⁷⁰ *Id.* at 65,136.

⁷¹ *Id.* at 65,135–36.

⁷² Emp. Benefits Sec. Admin., Field Assistance Bull. No. 2018-01, (Apr. 23, 2018), <https://www.dol.gov/sites/dolgov/files/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-01.pdf> [<https://perma.cc/6ECF-WSZE>].

collateral considerations as tie-breakers for an investment choice.⁷³ Thus, said 2018 bulletin confirms that a fiduciary acting under the prudent investor standard should consider material ESG factors that have financial impact.⁷⁴

B. *Prudent Investor*

The act of the fiduciary must also fulfill the fiduciary duty of the prudent investor called prudence of trust law. This requires the trustee to act “as a prudent person would,” exercising “reasonable care, skill, and caution.”⁷⁵ In terms of investment issues, the prudent investor rule codifies the risk management principles rooted in the Modern Portfolio Theory (“MPT”).⁷⁶ As a matter of law, the clear doctrinal basis of the prudent investor rule is that “[s]pecific investments or techniques are not per se prudent or imprudent.”⁷⁷ Instead, “[a] trustee may invest in any kind of property or type of investment” so long as the investment is “part of an overall investment strategy having risk and return objectives reasonably suited to the trust.”⁷⁸ As long as the resulting overall portfolio is diversified and its overall risks and returns are consistent with the terms and purposes of the trust, the prudent investor rule permits trustees to make any type of investment.⁷⁹ The duty of care includes the prudent investor standard, which is the duty to act as a prudent investor with respect to investment assets managed by the fiduciary.⁸⁰

As such, the Restatement (Third) of Trusts adopted the prudent investor rule in 1990, incorporating the basic principles of the MPT.⁸¹ In 1994, the Uniform Law Commission promulgated the Unified Prudent Investor Act (“UPIA”), codifying the rule.⁸² Affected by the MPT, UPIA instructed prudent trustees to manage the risk of the entire portfolio. UPIA also stresses diversification “unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying.”⁸³ UPIA directs trustees to consider a number of factors, including factors specific to the purpose of the trust and the interests of the beneficiary, as well as factors that take into account current and future

⁷³ *Id.*

⁷⁴ Gary, *supra* note 27, at 792–93.

⁷⁵ RESTATEMENT (THIRD) OF TRUSTS § 77(2) (AM. L. INST. 1995); *see also* UNIF. TR. CODE § 804 (UNIF. L. COMM’N 2000).

⁷⁶ *See* Schanzenbach & Sitkoff, *supra* note 3, at 425–26.

⁷⁷ RESTATEMENT (THIRD) OF TRUSTS § 90 cmt. f(2) (AM. L. INST. 1995).

⁷⁸ UNIF. PRUDENT INV. ACT § 2(b), (e) (UNIF. L. COMM’N 1994).

⁷⁹ *See id.* at 1 (“All categoric restrictions on types of investments have been abrogated; the trustee can invest in anything that plays an appropriate role in achieving the risk/return objectives of the trust and that meets the other requirements of prudent investing.”).

⁸⁰ *See* RESTATEMENT (THIRD) OF TRUSTS at 287–92.

⁸¹ *Id.* at 287. The American Law Institute adopted the prudent investor rule in 1990 and published the rule as §§ 227–229 of the Restatement (Third) of Trusts in 1992. The prudent investor rule was renumbered and now appears as §§ 90–92.

⁸² UNIF. PRUDENT INV. ACT (UNIF. L. COMM’N 1994).

⁸³ *Id.* at § 3.

economic conditions. UPIA was developed as a result of the evolution of financial standards, and the Restatement explains with respect to the prudent investor standard its intention to create a flexible and evolving standard.⁸⁴ The prudent investor follows industry standards and the idea of what is prudent changes as the standard changes. That evolution now constitutes ESG integration and may include a longer period of investment.

C. *Impartiality*

Most trusts, all pension plans and charities have multiple beneficiaries. For example, pension plans have different generations of participants who are eligible for distributions at different times. As set forth in Restatement (Third) of Trusts § 183, the fiduciary duty of impartiality requires a fiduciary to treat different generations of beneficiaries impartially.⁸⁵ In general, this means a balance of the interests of the income beneficiaries and the remaindermen.⁸⁶ Long-term value is important for trustees who are concerned about their duty of impartiality. This duty is an extension of the duty of loyalty and requires the trustee to act in the best interests of the beneficiaries, but the duty recognizes that they have competing financial interests in the trust.⁸⁷ Therefore, the duty does not require the trustee to treat each beneficiary equally, but depending on the purpose of the trust, plan, or endowment, requires it to consider different needs of all current and future beneficiaries.⁸⁸ When long-term systemic risk affects investors, fiduciaries who ignore material long-term information may be in breach of their duty to be prudent investors.

IV. DISCUSSION

In accordance with Schanzenbach and Sitkoff, as discussed in III.A.3, the duty of loyalty prohibits collateral benefits ESG as a mandatory rule under ERISA and as a default rule in charity and personal trusts. Based on the Supreme Court's current ERISA interpretation, pension trustees may not consider collateral benefits in their investment decisions, which violates the sole interest rule. As a result, Schanzenbach and Sitkoff conclude that ESG investment is permissible if the trustee reasonably concludes that ESG

⁸⁴ See RESTATEMENT (THIRD) OF TRUSTS ch. 17, intro. note (AM. L. INST. 2007); *Id.* at 287–92.

⁸⁵ See *Arken v. City of Portland*, 263 P.3d 975, 1006 (Or. 2011) (describing the Restatement of Trusts makes clear that a trustee has a duty of impartiality and must administer the trust impartially and with due regard for the diverse beneficial interests created by the terms of the trust.) (quoting RESTATEMENT (THIRD) OF TRUSTS § 79(1)(a) (AM. L. INST. 2003)).

⁸⁶ RESTATEMENT (THIRD) OF TRUSTS § 90 cmt. i (AM. L. INST. 2007).

⁸⁷ RESTATEMENT (THIRD) OF TRUSTS § 79 cmt. b (AM. L. INST. 2007) (describing the duty of impartiality as an extension of the duty of loyalty to beneficiaries but including unavoidable and permissible conflicting duties to beneficiaries with their competing interests).

⁸⁸ *Id.*

investing will benefit the beneficiary directly by improving risk-adjusted return, and if the trustee's exclusive motive for ESG investing is to obtain this direct benefit.

In contrast, Langbein believes that even if a trustee gains or may gain some benefits, prudent transactions to promote the beneficiary's best interests best serve the purpose of the duty of loyalty. In other words, if a trustee acts in the beneficiary's best interest, overlaps or conflicts of interest that are consistent with the best interest of the beneficiary should be permitted. The rules proposed by Langbein are: (1) the trustee has a duty to manage the trust in the best interests of the beneficiary; and (2) it is presumed that a trustee who does not manage trust in the beneficiaries' sole interest have not managed it in their best interests. The trustee may rebut the presumption by showing that the transaction that is not in the beneficiaries' sole interest only was made prudently in the beneficiaries' best interest.⁸⁹ There have been previous concerns that trustees operating in potential conflicts could easily hide wrongdoing. However, improvements in standards, practices, and technology of trust recordkeeping, and the enhanced disclosure duty have substantially eliminated the concerns. Langbein argues that there was a need for the sole interest rule to prevent trustee wrongdoing, but that the resulting overdeterrence would undermine the interests of the beneficiaries. Thus, a trustee must act in the best interests of the beneficiaries, but not necessarily in the sole interests thereof. The sole interest rule severity is based on outdated assumptions. Under the rules thus modified, fiduciaries are allowed to defend the claim of a breach of the duty of loyalty by demonstrating that a conflict of interest transactions were prudently conducted in the best interest of the beneficiaries. I agree on this argument. I discuss below on several points in favor of the abandonment of the strict sole interest rule.

A. *The Department of Labor's Position*

For example, in the 2008 interpretation bulletin, the Department of Labor stated that "ERISA's plain text does not permit fiduciaries to make investment decisions on the basis of any factor other than the economic interest of the plan."⁹⁰ However, the bulletin contemplates the possibility of investments that meet the risk-adjusted return objectives and a particular economic or other type of return to other parties. The Department of Labor further therein stated that, in limited circumstances, it has permitted fiduciaries to choose between otherwise equivalent investment options based on "a factor other than sole economic benefit to the plan, such as societal benefits."⁹¹ The 2015 guidance aims to make it clear that plan fiduciaries can

⁸⁹ Langbein, *supra* note 20, at 982.

⁹⁰ Paul Rose, *Public Wealth Maximization: A New Framework for Fiduciary Duties in Public Funds*, 18 U. ILL. L. REV. 891, 897 (2018) (criticizing the sole interest rule for pensions and arguing that the public should also be considered a beneficiary).

⁹¹ *Id.* at 897–98.

properly consider factors such as SRI factors that can affect risk and return.⁹² When viewed in this way, ESG factors “may have a direct relationship to the economic value of [an investment],” and in such cases “are not merely collateral considerations or tiebreakers [among economically equivalent investments], but rather are proper components . . . of the economic merits” of an investment.⁹³ The guidance also states that investments targeted in part based on the collateral benefits are also appropriate “so long as the investment is economically equivalent, with respect to return and risk to beneficiaries in the appropriate time horizon, to investments without such collateral benefits.”⁹⁴ As such, the Department of Labor permitted a factor other than the sole economic benefit to the plan including social benefits, and an investment based on the collateral benefits so long as the investment is economically equivalent. Moreover, in some examples, including the 2008 bulletin itself, the Department of Labor interpreted the term “exclusive” to mean “primary” rather than “sole.”⁹⁵

B. Delaware’s Prudent Investor Statute

The line of a settlor’s freedom that balances beneficiary interests with other interests is contested by both law and policy.⁹⁶ Delaware is now aware that the “interests” of the beneficiaries may include personal values and financial interests. The Delaware amendment added in the trust instrument the following: “The manner in which a fiduciary should invest assets, including whether to engage in 1 or more sustainable or socially responsible investment strategies, in addition to, or in place of, other investment strategies, with or without regard to investment performance.”⁹⁷ Moreover, in addition to the financial considerations in the fiduciary’s investment decisions, Delaware amended its prudent investor statute in 2018 to include ESG factors as follows:

⁹² J. Haskell Murray, *Social Enterprise and Investment Professionals: Sacrificing Financial Interests?*, 40 SEATTLE U. L. REV. 765, 780 (2017) (finding I.B. 2015-01 in this regard stated that “[f]iduciaries need not treat commercially reasonable investments as inherently suspect or in need of special scrutiny merely because they take into consideration environmental, social, or other factors.”). See 80 Fed. Reg. 65,135-01 (Oct. 26, 2015).

⁹³ 80 Fed. Reg. at 65,136.

⁹⁴ *Id.* Cf. Jennifer S. Fan, *Woke Capital: The Role Of Corporations In Social Movements*, 9 HARV. BUS. L. REV. 441, 488 (2019) (arguing “[t]he [Department of Labor] is ‘clarifying’ that when fiduciaries make investment decisions, they cannot make such decisions at the expense of returns nor can they assume greater risks so that they can promote collateral ESG policy goals.”).

⁹⁵ See 29 C.F.R. § 2509.08-1 (2013) (permitting fiduciaries to choose between investments of equal economic value to the plan). See also David H. Webber, *The Use and Abuse of Labor’s Capital*, 89 N.Y.U. L. REV. 2106, 2130 (2014).

⁹⁶ Schanzenbach & Sitkoff, *supra* note 3, at 417.

⁹⁷ See DEL. CODE ANN. tit. 12, § 3303(a)(4) (2014) (describing “sustainable or socially responsible investment strategies”).

In making investment decisions, a fiduciary may consider the general *economic conditions*, the anticipated tax consequences of the investment and the anticipated duration of the account and the needs of the beneficiaries; when considering the needs of the beneficiaries, the fiduciary may take into account the financial needs of the beneficiaries as well as the beneficiaries' personal values, including the beneficiaries' desire to engage in sustainable investing strategies that align with the beneficiaries' social, environmental, governance or other values or beliefs of the beneficiaries.⁹⁸

As such, Delaware became the first state in 2018 to address by the statutory provisions of a trust approving ESG investment.

Literally, this provision deviates from common law to verify the authorization or mandate in terms of trusts that implement ESG investment programs that sacrifice returns to achieve a benefit for a third party or for moral or ethical reasons.⁹⁹ The amendment to Delaware statute reflects the overlapping duty of acting as a prudent investor and the duty of loyalty. If a fiduciary must act in the beneficiary's "best interests," whether "best interests" mean more than financial interests affects how the fiduciary invests. UPIA has already instructed the fiduciary to consider the special relationship of the asset to the purpose of the trust or the beneficiary,¹⁰⁰ so in some circumstances the fiduciary already considers more than just financial interests. The change in Delaware statute reflects the view that some beneficiaries may be interested in more than financial interests.¹⁰¹

C. Economic Interests of Plan Participants and Beneficiaries

Section 404 of ERISA provides the exclusive purpose rule: "[A] fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and (A) for the exclusive purpose of (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan."¹⁰² The fiduciary's duties arises "with respect to a plan."¹⁰³ The exclusive purpose rule must not

⁹⁸ DEL. CODE ANN. tit. 12, § 3302(a) (2018) (emphasis added).

⁹⁹ At the end of section 3303(a), a conditional clause follows, which provides that "nothing contained in this section shall be construed to permit the exculpation or indemnification of a fiduciary for the fiduciary's own willful misconduct." *Id.* at § 3303(1)(6). In this regard, Schanzenbach and Sitkoff argue that "[a]rguably, a trustee would be in breach of trust in spite of settlor authorization of an ESG investment program if the specific program implemented by the trustee amounted to 'willful misconduct.'" See Schanzenbach & Sitkoff, *supra* note 3, at 418.

¹⁰⁰ UNIF. PRUDENT INV. ACT § 2(c)(8) (UNIF. L. COMM'N 1994).

¹⁰¹ Gary, *supra* note 27, at 794.

¹⁰² 29 U.S.C. § 1104(a) (2006).

¹⁰³ *Id.*

unduly limit the consideration of the broad economic interests of plan participants and beneficiaries. The plain text of an exclusive purpose rule does not necessarily exclude economic interests of plan participants and beneficiaries that are outside the economic interests of the plan. It can be, should be, and has been read more broadly. In fact, there are multiple cases that suggest that the duty of loyalty is carried out directly to the fund participants and beneficiaries, rather than to the fund, which upholds a member-first view.¹⁰⁴

The benefits provided to plan participants and beneficiaries are closely linked to the participants' employment by the state, county, or municipality that sponsors the plan. For example, loss of employment means reduced retirement benefits.¹⁰⁵ Trustees who consider the impact of plan investments on employment of the fund participants and beneficiaries, due to the close relationship between employment and retirement benefits, may discharge their "duties with respect to a plan solely in the interest of the participants and beneficiaries and (A) for the exclusive purpose of (i) providing benefits."¹⁰⁶ Increasing employment causes economic benefits of the plan participants and beneficiaries in plan investments.

D. Mutual Funds

Section 802 of Uniform Trust Code (UTC), much of which was derived from Restatement (Second) of Trusts § 170 (1959) and is also found in Restatement (Third) of Trusts § 78 (2007), codifies the duty of loyalty. Under most states' UTC and statutes,¹⁰⁷ financial institutions that act as trustees are allowed to invest trust assets in mutual funds for which they provide investment advice and other services even if they receive fees from the mutual funds for those services in addition to regular trustee's fees.¹⁰⁸ Thus, the fiduciary is entitled to both the fiduciary's fees and the fees for providing investment services to the mutual fund. As explained in the comments to section 802, duty of loyalty issues, for example, when the trustee is also a beneficiary, or when the settlors nominate a member of a family member who is a friend or officer of a family member. It often happens. A company whose settlors own shares.¹⁰⁹ As stated in UTC's comments, such mutual fund investment by trustees brings both advantages and disadvantages to

¹⁰⁴ Webber, *supra* note 95, at 2125.

¹⁰⁵ See *Bandt v. Bd. of Ret. of the San Diego Cnty. Emps. Ret. Ass'n*, 136 Cal. App. 4th 140, 159 (Ct. App. 2006) ("[T]he pension of a member who loses his job will be dramatically affected by that job loss.").

¹⁰⁶ 29 U.S.C. § 1104(a) (2006).

¹⁰⁷ See UNIF. TR. CODE § 802 cmt. (UNIF. L. COMM'N 2010) (noting that prior to the UTC "[n]early all of the states [had] enacted statutes authorizing trustees to invest in funds from which the trustee might derive additional compensation.").

¹⁰⁸ See, e.g., See UNIF. TR. CODE § 802(f) (UNIF. L. COMM'N 2010); OHIO REV. CODE ANN. § 1111.13 (2007).

¹⁰⁹ See generally Alan Newman, *Trust Law in the Twenty-First Century: Challenges to Fiduciary Accountability*, 29 QUINNIPIAC PROB. L.J. 261 (2016).

beneficiaries as follows:

[Advantages:] Mutual funds commonly offer daily pricing, which gives trustees and beneficiaries better information about performance. Because mutual funds can combine fiduciary and non-fiduciary accounts, they can achieve larger size, which can enhance diversification and produce economies of scale that can lower investment costs.

[Disadvantages:] Trustee investment in mutual funds sponsored by the trustee, its affiliate, or from which the trustee receives extra fees has given rise to litigation implicating the trustee's duty of loyalty, the duty to invest with prudence, and the right to receive only reasonable compensation. Because financial institution trustees ordinarily provide advisory services to and receive compensation from the very funds in which they invest trust assets, the contention is made that investing the assets of individual trusts in these funds is imprudent and motivated by the effort to generate additional fee income. Because the financial institution trustee often will also charge its regular fee for administering the trust, the contention is made that the financial institution trustee's total compensation, both direct and indirect, is excessive.¹¹⁰

Despite these concerns as pointed out as disadvantages, however, virtually all states intervene to exempt affiliated mutual funds from a sole interest rule,¹¹¹ and the Uniform Trust Code has now codified such exception.¹¹²

Section 802(f) provides that a trustee's investment in such a mutual fund "is not presumed to be affected by a conflict between [the trustee's] personal and fiduciary interests," although the trustees still follow the prudent investment discipline.¹¹³ Furthermore, a trustee is not prohibited under UTC by its duty of loyalty from investing trust assets in mutual funds for which it (or affiliate) provides compensation services, but the trustee remains subject to the duty of loyalty.¹¹⁴ As noted above, the official comment points out that the duty of loyalty still requires the trustee not to "place its own interests ahead of those of the beneficiaries."¹¹⁵ Therefore, even if the statute precludes the sole interest rule, the trustee is subject to the duty to act in the

¹¹⁰ UNIF. TR. CODE § 802 cmt. (UNIF. L. COMM'N 2010).

¹¹¹ *E.g.*, CAL. PROB. CODE § 16015 (West 1991); 760 ILL. COMP. STAT. 5/5.2 (2004) (repealed 2019); N.Y. EST., POWERS, & TRS. L. § 11-2.2(a)(6) (2001).

¹¹² Langbein, *supra* note 20, at 973.

¹¹³ UNIF. TR. CODE § 802(f), 7C U.L.A. 229 (Supp. 2000) (The measure also requires regular annual disclosure to trust beneficiaries of certain compensation arrangements between trustee and mutual fund.).

¹¹⁴ See generally David English, *The Fiduciary Duties and Powers of a Trustee Under the Uniform Trust Code*, in 20(2) TRUSTS & TRUSTEES 52 (2013).

¹¹⁵ UNIF. TR. CODE § 802, 7C U.L.A. 229 (Supp. 2000) at cmt.

best interests of the beneficiary in deciding whether to use the affiliated funds. The trustee derives fee income from both the mutual fund and the trust, but the trustee's duty of cost sensitivity¹¹⁶ requires that the total costs be adequate and reasonable. If the trustee receives compensation from an investment institution or investment trust to provide investment advisory or investment management services, the trustee must annually inform the persons under Section 813 to receive a copy of the trustee's annual report of decided compensation. Thus, to some extent, UTC exempts affiliated mutual funds from a sole interest rule.

E. *Difference from Corporate Law*

The abandonment of the sole interest rule in corporate law provides an important comparison with trust law. In the past, the corporate law applied the sole interest rule of the trust law to corporate transactions with directors. However, from the latter half of the 19th century to the 20th century, corporate law changed direction and rejected the trust law solution.¹¹⁷ Corporate law has recognized that some conflicts can benefit companies and has replaced prohibition with regulation.¹¹⁸ The American Law Institute's *Principles of Corporate Governance* have avoided using the term "duty of loyalty" and instead use the term "duty of fair dealing."¹¹⁹ In the case of stakeholders' overlap or conflict in corporate activities, the company's interests are often better served by facilitating rather than by prohibiting mutually beneficial transactions.¹²⁰ With respect to the cause of abandonment of the sole interest rule, Robert Clark said that certain self-dealing transactions might be not only normal and virtually unpreventable, but also positively advantageous to the corporation, hence the movement to more selective rules that would allow the non-abusive self-dealing transactions to occur. Under the best interest rule, the policy decision is whether a conflicted action will be in the beneficiaries' best interests, with sufficient frequency that the beneficiaries are better off with a regulatory rule rather than prohibitory rule.¹²¹ Therefore, instead of categorically prohibiting all transactions in which the trustee may be interested, the best interest rule should permit them, but subjects them to judicial review under a fairness test.¹²² In contrast, the sole interest rule precautionary policy suits situations where conflicted transactions are unlikely to be beneficial and the beneficiary monitoring is less workable. In other words, "the policy of the trust law is to prefer (as a matter of default law) to remove altogether the occasions of temptation rather than to monitor fiduciary behavior and attempt

¹¹⁶ See Schanzenbach & Sitkoff, *supra* note 3, at 418 n.193.

¹¹⁷ See MODEL BUS. CORP. ACT § 8.60 annot. (History), at 8-389 (2002); ROBERT C. CLARK, CORPORATE LAW § 5.1, at 160-66 (1986).

¹¹⁸ Langbein, *supra* note 20, at 958-62.

¹¹⁹ 1 AM. L. INST., PRINCIPLES OF CORPORATE GOVERNANCE 200 (1992).

¹²⁰ Langbein, *supra* note 20, at 958-60.

¹²¹ Schanzenbach & Sitkoff, *supra* note 3, at 402-03.

¹²² *Id.* at 403.

to uncover and punish abuses when a trustee has actually succumbed to temptation.”¹²³

The trust has changed function, from a device for holding and transferring family real estate into its characteristic modern role as a management regime for a portfolio of financial assets. The process through which a hedge fund manager values the complex instruments in the fund's portfolio causes a significant conflict of interest.¹²⁴ Fund managers serve not in the sole interest of the beneficiary but also to make money for themselves and their shareholders. The valuation process influences hedge fund managers' decisions from risk management to their compensation, which, in turn, affects many aspects of the relationship between fund managers and investors.¹²⁵ In addition to determining the size of the management fee and the performance fee, hedge fund investors decide whether to remain invested in the fund or withdraw their money. With respect to “withdraw,” furthermore, trusts restrict the ability of trust beneficiaries to dispose of trust property or to escape the managerial authority of the trustee,¹²⁶ while shareholders of a publicly traded company can disengage from a mismanaged corporation by selling the shares. In contrast, most fund investors have special exit rights and are protected by unusually strong incentive compensation systems.¹²⁷ The difficulties of exit from trust relations bear on the more protective character of both the care and the loyalty norms of trust law.¹²⁸ In these circumstances, a rule recognizing mutual benefit is better than insisting upon the sole interest rule.

F. *Inevitability of Internalization of Externalities*

We should separate money making activities from ethical ones. “Let companies make money and let individuals and governments deal with externalities.”¹²⁹ The strict fiduciary duty to act in the interests of the fund obliges a private investor to ignore such externalities, unless they adversely affect the returns of the fund investments. On the other hand, we should take into consideration the company-specific risk which is the forced

¹²³ RESTATEMENT (THIRD) OF TRUSTS § 78(1)-(2) cmt. b (Am. L. Inst. 2007).

¹²⁴ See FIN. SERVS. AUTH., *Hedge Funds: A Discussion of Risk and Regulatory Engagement*, March 2006, at 3–14.

¹²⁵ Ryan Sklar, Note, *Hedges or Thickets: Protecting Investors From Hedge Fund Managers' Conflicts of Interest*, 77 *FORDHAM L. REV.* 3251, 3267–68 (2009).

¹²⁶ In American trust law, the beneficiaries may not terminate a trust if continuing it “is necessary to carry out a material purpose of the trust.” RESTATEMENT (SECOND) OF TRUSTS § 337(2) (Am. L. Inst. 1959); accord UNIF. TR. CODE § 411(b), 7C U.L.A. 189 (Supp. 2000).

¹²⁷ John Morley, *The Separation of Funds and Managers: A Theory of Investment Fund Structure and Regulation*, 123 *YALE L.J.* 1228, 1232–33, 1245–46 (2014) (arguing that investors in every type of investment fund have the right periodically to withdraw their money or otherwise remove it from managers' control.).

¹²⁸ See further Langbein, *supra* note 20, at 962.

¹²⁹ Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 *J.L. FIN. & ACCT.* 247, 249 (2017).

internalization of the costs previously externalized. Previously, companies could use water for production and release polluted water without economic impact. Regulations on pollutant emissions require companies to internalize some of these costs. Many system-level issues reflect costs that have not yet been internalized.¹³⁰ While the cost of emissions now externalized may be internalized in the future due to government regulations and taxes, the risk of increased internalization costs may not be reflected in traditional financial measures. The costs of climate change may also suddenly become internalized.¹³¹ As another example, these risks include supply chain disruptions caused by climate change.¹³² Disruptions caused by floods, hurricanes, or wildfires may rapidly internalize these costs through supply chain disruptions or commodity price fluctuations. Although climate change is external to a particular company, it poses a financial risk to other companies and their shareholders and will be internalized.¹³³

Here is an actual example. In the late 1990s, Nike was subjected to public disapproval (including consumer boycott), substantial loss of profits, and loss of reputation when it was reported that Nike engaged in exploitative employment practices in overseas factories, particularly in Asia.¹³⁴ Taking this opportunity, it came to be recognized that corporate responsibility must ensure the working environment and health and safety conditions of suppliers and address human rights issues including child labor. It means that global companies must fulfill their “corporate social responsibility” throughout the supply chain. After that discussion, UN Special Representative Ruggie introduced the United Nations Guiding Principles on Business and Human Rights (“Guiding Principles”) that provide thirty-one principles that help to operationalize the Protect, Respect, and Remedy Framework.¹³⁵ Furthermore, the California legislature moved to remedy the problem with the California Transparency in Supply Chains Act of 2010 (TSCA),¹³⁶ which requires certain highly profitable companies doing business in the state to

¹³⁰ See Georges Dyer, *Why Intentionally Designed Endowments Matter for Business*, GREENBIZ (Mar. 19, 2015), <https://www.greenbiz.com/article/why-intentionally-designed-endowments-matter-business> [<https://perma.cc/MH6L-4UTK>].

¹³¹ See Susanna Rust, *ESG: From Niche to Norm?*, INVS. & PENSIONS EUR. (Apr. 2017), <https://www.ipe.com/investment/esg/esg-from-niche-to-norm/www.ipe.com/investment/esg/esg-from-niche-to-norm/10018287.fullarticle> [<https://perma.cc/5RTJ-BS4P>].

¹³² Gary, *supra* note 27, at 759.

¹³³ Sarah Fecht, *NYC is Suing Five Major Oil Companies Over Climate Change*, EARTH INST. BLOG (Jan. 11, 2018), <http://blogs.ei.columbia.edu/2018/01/11/nyc-climate-change-lawsuit/> [<https://perma.cc/UY46-NUC9>].

¹³⁴ See Randall L. Waller & Roger N. Conaway, *Framing and Counterframing the Issue of Corporate Social Responsibility*, 48 J. BUS. COMM. 83, 97–103 (2011), <http://www.sagepub.com/cornelissen3e/Online%20reading%20pdfs/Waller.pdf>.

¹³⁵ See Special Representative of the U.N. Secretary-General, *Guiding Principles on Business and Human Rights: Implementing the United Nations “Protect, Respect and Remedy” Framework*, U.N. Doc. A/HRC/17/31, at 4–34 (Mar. 21, 2011).

¹³⁶ S. 657, Cal. Legis. Sess. (2009) (enacted).

post disclosures on their websites regarding their efforts to eradicate human trafficking and slavery from their supply chains.¹³⁷

As a general matter, Hart and Zingales disagree with said story (i.e., separating money-making activities from ethical activities, and letting companies make money and letting individuals and governments handle externalities) because they believe that money-making and ethical activities are often inseparable. They pick up the case where Walmart sells high-capacity magazines of the sort used in mass killings. If shareholders are concerned about mass murder, transferring profits to shareholders to spend on gun control may not be as efficient as first prohibiting the sale of high-capacity magazines in the first place.¹³⁸

Hart and Zingales proposes that companies should pursue shareholder welfare maximization, rather than value maximization.¹³⁹ Their paper argued that Friedman was correct¹⁴⁰ only if the profit-making and damage-generating activities of companies were separable, or if government fully internalizes externalities through legislation. Without these conditions, shareholder welfare and market value are not the same, and companies need to maximize the former rather than the latter.¹⁴¹ One way to facilitate this is to have shareholders vote on a broad overview of corporate policy.¹⁴²

The recent tendency of focusing on ESG factors comes from the change in public firms' shareholding structures, which are now dominated by institutional investors. According to their business strategy, index funds commit to replicate an index, and cannot easily divest of troubled stocks. They have no incentive to monitor investee company's management, including collective action problems and fee structure.¹⁴³ These institutional

¹³⁷ Cal. Civ. Code § 1714.43 (West 2017).

¹³⁸ Hart & Zingales, *supra* note 129, at 249.

¹³⁹ *Id.* at 250. See also Rose, *supra* note 90, at 923 (arguing that focusing on public wealth maximization, positive externalities should also be taken into account in investment decisions, which can result in increased investment in sustainable companies and long-term projects).

¹⁴⁰ Hart & Zingales, *supra* note 129, at 248 (discussing Milton Friedman, *The Social Responsibility of Business is to Increase Its Profits*, N.Y. TIMES MAG., Sept. 13, 1970, at 32).

¹⁴¹ See Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 738–40 (2005) (arguing that patent profit-sacrificing is consistent with the maximization of shareholders' welfare to the extent that the managers' actions faithfully translate the preferences of most shareholders). See also *id.* at 783–96 (further stating that maximizing shareholder welfare is not the same thing as maximizing profits, and “patent” profit-sacrificing is consistent with the maximization of shareholders' welfare).

¹⁴² Hart & Zingales, *supra* note 129, at 270.

¹⁴³ See, e.g., Jill E. Fisch, *Relationship Investing: Will It Happen? Will It Work?*, 55 OHIO STATE L.J. 1009, 1024 (1994). In the line of passive investments, see also Edward Rock & Marcel Kahan, *Index Funds and Corporate Governance: Let Shareholders be Shareholders* 16 (N.Y.U. Law & Econ. Paper Series, Working Paper 18-39, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3295098.

investors, large asset managers in particular, are more sensitive to risk than dispersed shareholders. That is because they cannot liquidate their holdings as readily and are thus exposed to risks that are harder to diversify. Such risk, external risk in particular which is difficult to discover, may hurt companies devastatingly as described above. The focus on short-term profits has ignored and precluded external risks and then produced externalities. However, the external risks can no longer be ignored. The scope of information requested by sustainability is in general much wider than that requested by corporate compliance. For instance, it is well recognized that the issue of climate change is not a matter of legal compliance, but that of sustainable growth of companies and economies. Furthermore, turning to gender in the workplace, compliance focuses on sexual harassment and discrimination,¹⁴⁴ while sustainability looks at issues such as women's representation in leadership roles.¹⁴⁵ Important is how a company will establish such corporate governance structure in which such external risk will be internalized.

G. Improvement on Recordkeeping, etc. and Change of Trust Function

With respect to a concept of prevention of concealing wrongdoing, the expansive disclosure standards of modern trust fiduciary law, reinforced by the modern trustee's extensive recordkeeping responsibilities,¹⁴⁶ oblige the trustee to create suitable records and make them available¹⁴⁷ when they bear on the beneficiary's interest. These radically changed circumstances largely overcome the concern of the 18th and early 19th century chancellors that a conflicted trustee had an insuperable advantage at concealment.¹⁴⁸

As the trust has changed function, from a device for holding and transferring family real estate into its modern role for a portfolio of financial

¹⁴⁴ See Terry Morehead Dworkin & Cindy A. Schipani, *The Role of Gender Diversity in Corporate Governance*, 21 U. PA. J. BUS. L. 105, 123 (discussing redress for sexual harassment and sex discrimination under Title VII).

¹⁴⁵ See Emma Hinchliffe, *The Firm Behind 'Fearless Girl' Has a Dubious Record of Backing Gender Diversity as a Shareholder*, FORTUNE (Apr. 1, 2019, 6:00 AM), <https://fortune.com/2019/04/01/state-street-fearless-girl-shareholder-resolutions/> [<https://perma.cc/3NLT-FZJG>] (describing campaigns to increase women's representation on company boards).

¹⁴⁶ Regulatory authorities emphasize trust recordkeeping as part of their audit and examination standards. See, e.g., 12 C.F.R. §§9.8–9.9 (2004) (regulating recordkeeping, record retention, and audit by the Comptroller of the Currency).

¹⁴⁷ The Uniform Trust Code emphasizes the trustee's responsibility to initiate disclosure whenever it would be significantly related to keep the beneficiaries "reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests." See UNIF. TR. CODE 813(a), 7C U.L.A. 239 (Supp. 2000). Although the statutory text of ERISA does not express the duty of disclosure, courts have held that the ERISA fiduciary has a duty "to convey complete and accurate information when it speaks to participants and beneficiaries regarding plan benefits." See *In re Unisys Savings Plan Litigation*, 74 F.3d 420, 441 (3d Cir. 1996).

¹⁴⁸ Langbein, *supra* note 20, at 944–51.

assets, the trust has changed character. Moreover, those changes are now reflected in the standards of trust fiduciary law and are reinforced by an expanded duty of disclosure to the trust beneficiary. Thus, routine trust administration now greatly reduces the danger that justified the sole interest rule, the fear that without a prohibitory rule a conflicted trustee could easily conceal evidence of misappropriation. In the financial services industry, financial institutions serve not in the sole interest of the beneficiary but also to make money for themselves and their shareholders. Thus, the scope of the sole interest rule has been diminished, as evidenced in the exceptions, for instance, for affiliated mutual funds. In such circumstances, a rule recognizing mutual benefit is better than insisting upon the sole interest rule.

H. *Brief Summary (In Response to Criticism)*

Leslie criticizes Langbein because his theory will bring a great disadvantage to the beneficiaries if the no further inquiry rule is abolished and instead the best interest defense is adopted.¹⁴⁹ The beneficiaries do not have the ability to monitor the actions of the trustee, it is not easy for them to exit from the trust, and there is no external pressure on the trustees. Leslie argues that is why the strict “no further inquiry rule” is needed. In this context, Leslie also opposes the idea of bringing the fiduciary duty of corporate officers and directors into that of the trustees.¹⁵⁰ From this point of view, Leslie also criticizes the UTC Section 802(f), since until recently, in the Restatements, the transactions with the trustee's affiliated companies were deemed as self-dealings and the strict sole interest rule was applied to such transactions, but the UTC Section 802(f) describes that self-interested investing is no longer subject to the no further inquiry rule, which she argues is inappropriate.¹⁵¹ Of course, her view also makes sense. A clue to the solution to this discussion would be to analyze why the sole interest rule and the no further inquiry rule have arisen and why they should still be maintained. It seems that the best interest rule, which is a rule for permitting conflicts or overlaps of interest that are consistent with the best interest of the beneficiary, is better for fund managers. However, the best interest rule should not be applied in all cases. In making such decision on application, it will be important whether the beneficiaries can obtain sufficient information by monitoring and disclosure and appropriately examine the transaction, whether the beneficiaries have sufficient exit rights, and how often beneficial transactions with conflicting interests might be made in the process of managing the funds.

V. NECESSITY FOR INFORMATION DISCLOSURE ON ESG FACTORS

With pressure from investors and shareholders on sustainability reporting,

¹⁴⁹ Melanie B. Leslie, *In Defense of the No Further Inquiry Rule: A Response to Professor John Langbein*, 47 WM. & MARY L. REV. 541, 543 (2005).

¹⁵⁰ See *id.* at 554–63.

¹⁵¹ See *id.* at 571–79.

companies have the incentive to report. In fact, over 85% of companies in the S&P 500 produce voluntary sustainability reports, so some of this ESG information is already publicly available to investors and the capital markets.¹⁵² The resulting lack of standardization means that issuer disclosures vary substantially, which impedes comparability, which accordingly reduces the value of such disclosure. Moreover, sustainability reporting varies widely in quality, and its accuracy is rarely audited or monitored.¹⁵³ Although many ESG disclosure standards have been developed and some have been incorporated into mandatory reporting systems by non-U.S. regulators,¹⁵⁴ U.S. companies' implementation of the ESG disclosure framework remains voluntary at this time. The U.S. has considered mandating sustainability reporting for public companies, but to date such reporting remains largely voluntary.

Regulation S-K was adopted in 1977 to facilitate the unified and integrated disclosure of registration statements. In 1982, the Commission expanded and reorganized Regulation S-K to become the central repository for non-financial statement disclosure requirements.

In the United States, regulations issued by the Securities and Exchange Commission (SEC) require companies to report on significant business and financial factors, including significant environmental and social factors.¹⁵⁵ It is still difficult to determine what is important to a company. In April 2016, the SEC issued a concept release that discussed regulation S-K's business and financial disclosure regulations and required public comment on certain questions.¹⁵⁶ In the concept release, the SEC seeks to set whether the current reporting requirements "continue to provide the information that investors need to make informed investment and voting decisions and whether any of

¹⁵² GOVERNANCE & ACCOUNTABILITY INST. INC., *Flash Report: 86% of S&P Index Companies Publish Corporate Sustainability/Responsibility Reports in 2018* (2019), <https://www.ga-institute.com/press-releases/article/flash-report-86-of-sp-500-indexR-companies-publish-sustainability-responsibility-reports-in-20.html> [<https://perma.cc/ZW4V-4K8E>].

¹⁵³ Ioannis Ioannou & George Serafeim, *The Consequences of Mandatory Corporate Sustainability Reporting* (Harv. Bus. Sch. Working Paper No. 11-100, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1799589.

¹⁵⁴ Steve Lydenberg et al., *From Transparency to Performance: Industry-Based Sustainability Reporting on Key Issues*, INITIATIVE FOR RESPONSIBLE INV. 5-6 (2010), [<https://perma.cc/GZF6-KZ7J>] (observing that voluntary reporting regimes have made valuable contributions, but concluding that a mandatory sustainability reporting framework is needed to overcome existing problems on ESG data).

¹⁵⁵ See Business and Financial Disclosure Required by Regulation S-K, SEC Release No. 33-10064, BUSINESS AND FINANCIAL DISCLOSURE REQUIRED BY REGULATION S-K 209-10 (2016), <https://www.sec.gov/rules/concept/2016/33-10064.pdf> [<https://perma.cc/D6ZK-CAH7>]

¹⁵⁶ *Id.*

our rules have become outdated or unnecessary.”¹⁵⁷ In June 2016, the SEC's own Investor Advisory Board issued comments on the concept release and responded to the request for feedback.¹⁵⁸ In addition, in August 2019, the SEC presented a proposed amendment to modernize the description of business (Item 101), legal proceedings (Item 103), and risk factor (Item 105) disclosure requirements in Regulation S-K.¹⁵⁹

VI. CONCLUSION

Worldwide sustainable investment strategies including ESG investments are inevitable. To meet the demands of the times, it is a time to reconsider the reforming of fiduciary duty, especially the duty of loyalty. It has been argued that the duty of loyalty prohibits collateral benefits ESG as a mandatory rule under ERISA and as a default rule in personal trusts, and accordingly a pension trustee may not consider collateral benefits in any investment decision, which violates the sole interest rule. However, the area of application of the sole interest rule is gradually shrinking, and the circumstances underlying the rule have changed, which means the severity of the sole interest rule should be abandoned. Hence, the following rule should be applied: A trustee must act in the beneficiary's best interest, but not necessarily in the beneficiary's sole interest. Even if the trustee does not administer the trust in the sole interest of the beneficiaries, he/she may rebut the presumption of the violation by showing that a transaction has been prudently undertaken in the best interest of the beneficiaries. This rule is based on the following several changes in the situation surrounding the fiduciary duty of loyalty. First, the Department of Labor has permitted a factor other than the sole economic benefit to the plan including social benefits, and an investment based on the collateral benefits so long as the investment is economically equivalent. Moreover, the Department of Labor has interpreted the term “exclusive” to mean “primary” rather than “sole.” Second, prudent investor statutes including the Delaware statute authorize to undertake an ESG investment program that sacrifices returns to achieve a

¹⁵⁷ *Id.* at 6; *see also* Press Release, SEC, SEC Solicits Public Comment on Business and Financial Disclosure Requirements in Regulation S-K (Apr. 15, 2016), <https://www.sec.gov/news/pressrelease/2016-70.html> [<https://perma.cc/C4BH-R4EU>].

¹⁵⁸ Letter from SEC Inv. Advisory Comm. to SEC Div. of Corp. Fin. (June 15, 2016), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-approved-letter-reg-sk-comment-letter-062016.pdf> [<https://perma.cc/L4SN-KZS6>] (The comments argue the lack of well-developed guidance in the area of assessing qualitative factors and recommend the development of “an analytical framework that more clearly sets out the qualitative factors that can affect the analysis in this area.”).

¹⁵⁹ William H. Hinman, *Modernization of Regulation S-K*, HARV. L. SCH. F. CORP. GOVERNANCE (Aug. 13, 2019), <https://corpgov.law.harvard.edu/2019/08/13/modernization-of-regulation-s-k/> [<https://perma.cc/6B2D-9K34>].

benefit for a third party or for moral or ethical reasons. Third, according to Section 404 of ERISA, the exclusive purpose rule must not unduly limit the consideration of the broad economic interests of plan participants and beneficiaries. Fourth, under the UTC, a trustee is not prohibited by its duty of loyalty, from investing trust assets in mutual funds to which it (or an affiliate) provides compensated services, or from investing trust assets in mutual funds for which it (or an affiliate) provides compensation services. Fifth, the sole interest rule was abandoned in corporate law. The watershed for such abandonment is whether a conflicted transaction is unlikely to be beneficial and beneficiary monitoring is weak, whether it is appropriate to remove altogether the occasions of temptation rather than to monitor. Various interests and motives become included, and the situation around ESG investment is now near to corporate law rather than to simple trust law. Sixth, the forced internalization of costs that have been externalized in the past has been and will be increased. Seventh, the expansive disclosure standards of modern trust fiduciary law have been reinforced by the modern trustee's extensive recordkeeping responsibilities, which oblige the trustee to create and disclose suitable records. The trust has changed its function into a modern role for a portfolio of financial assets, and financial institutions serve not only in the sole interest of the beneficiary but also to make money for themselves and their shareholders. As such, in fact, the scope of the sole interest rule has been diminished gradually. Certainly, the sole interest rule can bind the trustee more strictly than the best interest rule. Obscuring the purpose of maximizing returns might admit the trustee's excuses for worse returns. However, whether a certain return satisfies the best interest rule can be evaluated using the Modern Portfolio Theory according to the prudent investor rule, and it can be disproved by disclosing important facts that it is in the best interests of the beneficiaries.

Here, I would like to return to the discussion of the purposes of companies and funds, in other words, "what to maximize." This is a debate about whether it is possible to promote stakeholder interests (that is, ESG factors) to the extent that they contribute to the promotion of corporate value, or even if they do not contribute to the promotion of corporate value (or even do sacrifice the corporate value). In my opinion, which is the same as that of Hart and Zingales,¹⁶⁰ and Elhauge,¹⁶¹ maximizing shareholder interests in the corporate case should be maximizing shareholder welfare, not market value. The shareholder welfare here is, if simplified a little, defined as the interests of both shareholders and the other stakeholders, in other words, the so-called shareholder interests after internalizing externalities or external risks. In this respect, the conventional model for maximizing shareholder interests based on the market value cannot be adopted. Furthermore, institutional investors who are responsible for stewardship duties to the final investors should contribute to realizing such "shareholder value" by conducting engagement that takes stakeholder interests into consideration.

¹⁶⁰ See Hart & Zingales, *supra* note 129.

¹⁶¹ See Elhauge, *supra* note 141.

However, there is no change in the structure where management and directors make a comprehensive judgment based on the business judgment rule as to what contributes to the shareholder welfare. As for the funds, to the contrary, it has been argued that trustees can only consider the monetary interests of beneficiaries, and that modern portfolio theory aims to maximize returns. But in the case of a fund as well as in the case of a company, it is just as problematic what is the best interests of the beneficiaries, in other words, whether they are really equal to maximizing monetary return on investment. In the case of equity investment, if the investee company must internalize external costs and risks and aim to maximize shareholder welfare, the concept of investment purpose and investment return might be parallel to that of company purpose and corporate value.

It has been previously stated that Socially Responsible Investment (“SRI”) has the potential to increase social welfare. It may be considered that in modern times we have a common understanding of the improvement of social utility through investment. This is also equivalent to the question of whether it is permissible to raise social welfare at the expense of return on investment. However, I do not say that all companies should ignore profit maximization and run for social benefits. It is the management who decides whether it is right or wrong to sacrifice the monetary benefits, and ultimately the market evaluates it. Certainly, the criticism that maximizing shareholder interests is a clear standard and that obscuring it would bring management irresponsibility is right. With the discussion of ESG and SDGs as an opportunity, we should deepen the discussion once again about the purpose of the company and the purpose of the investment. I think this is one of the most important issues that scholars and practice should face in the modern capitalist economy.

The years of 2019 and 2020 have been those of making us think deeply about environmental issues and business continuity plans (BCPs) issues. Especially BCPs which ensure appropriate organization-wide preparedness and response in the face of emergencies have been formulated with the assumption of major disasters mainly caused by global climate change, but global supply chain outages due to the COVID-19 pandemic risk have been found a new risk to corporate sustainability in 2020. For instance, in addition to the potential cybersecurity risks, on a company scale as well as on a national scale, we must consider the infrastructural capacity needed to support electronic platforms, in which necessary information can be effectively communicated “B to B” and “B to C”. The ESG investment is an investing strategy in evaluating corporate sustainability. From the legal viewpoint, it is time to comprehensively determine what ESG information should be disclosed and used, what ESG factors should be evaluated and how, and what type of the ESG investing is permissible or required.