

Investor Fiduciary Duties in the Crosshairs – Targeting a Mirage

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The fiduciary duties of institutional investors have become a hot issue amongst policymakers and courts, with the future financial security of millions of American workers and savers at stake. Unfortunately, many recent policy debates and court opinions on investor fiduciary duties demonstrate only a limited understanding of fiduciary duty principles. A more complete appreciation of the full range of investor fiduciary duties is essential to inform policy and court decisions that affect the future financial security and economic stability of America. This article offers a guide to essential investment fiduciary concepts that have been missing from recent policy debates and court decisions.

SUMMARY

While policymakers and courts generally exhibit some familiarity with the fiduciary duties of loyalty and prudence, they give almost no attention to related legal principles that undergird those duties and are essential to their application. Among the overlooked principles that govern interpretation of the duty of loyalty are the following:

- **Strictest Duty** – The investor fiduciary duty of loyalty is subject to the trust standard, which is known as the strictest of fiduciary duties among all types of fiduciaries. For instance, fiduciary duties applicable to corporate directors are generally laxer (e.g., regarding conflicts of interest). People who are only familiar with standards applied to other types of fiduciaries or to elected public officials often fail to fully appreciate differences in the rules applicable to investor fiduciaries.
- **Trust Fund Standards** - Assets held in pension funds, mutual funds, college savings plans, endowments and similar collective investment vehicles do not belong to the governments, companies, managers or other agents who control them. Rather, such assets belong to the fund’s participants or beneficiaries and are held in trust. The agents who manage these trust assets cannot misappropriate or use trust funds to further their own or third party political, personal or policy goals – whether liberal or conservative.
- **Duty of Impartiality** – Investor fiduciaries have an obligation to identify, consider and make a good faith effort to balance competing interests between different groups of beneficiaries. For example, since younger and older beneficiaries have

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significantly different risk tolerance levels and investment horizons, pension fund fiduciaries must manage assets to address both short- and long-term risk and return obligations. However, this is rarely recognized in ongoing debates.

- **Duty of Obedience for Charitable Nonprofits** – While most investor fiduciaries must use fund assets to meet the financial needs of their beneficiaries exclusively, fiduciaries of charitable nonprofit endowments and foundations also have a duty of obedience to their organization’s mission goals. This duty obligates charitable nonprofit endowment and foundation fiduciaries to consider the charitable purposes of their sponsoring organization when investing fund assets. In some instances, these purposes may include environmental, social and other policy goals. Unfortunately, policymakers and courts often conflate investment practices of religious or other charitable nonprofits with those of different investors. Failure to recognize this distinction can distort the resulting analysis.

Similarly, fiduciary principles that inform interpretation of the duty of prudence have also been overlooked:

- **Future-Oriented Process** – The duty of prudence is process-oriented and forward looking. Investor fiduciaries must evaluate investments in the context of how they fit into the overall circumstances and strategies of their fund. Specific investments are not evaluated on a standalone basis. In addition, when exercising the full range of fiduciary duties, this focus on process can result in fiduciaries at different funds with dissimilar characteristics or circumstances using the same basic processes but reaching divergent results. Prudence is not an inflexible *one-size-fits-all* concept.
- **Governing Fiduciary Perspective** – Governing fiduciaries and investment managers usually play different roles. Governing fiduciaries are responsible for oversight of their entire fund or investment plan, while investment managers usually are given a specific mandate for only a portion of it. This can result in governing fiduciaries and investment managers having different perspectives, with the governing fiduciary bearing broader legal responsibilities for the entire fund or investment plan. However, policymakers and courts have tended to focus only on fiduciary duties from the perspective of individual investment managers (who are more visible). This can make them blind to how each manager fits into the overall fund structure established by the governing fiduciary and produce a skewed result where the total fund context is ignored.
- **Duty to Investigate Facts** – The prudent standard of care requires that investor fiduciaries investigate facts “relevant” to investment and management decisions. This fact-finding obligation precludes fiduciaries from jumping to conclusions. The duty contemplates use of a reasonable, good faith process of inquiry to inform decisions. Scope of this inquiry can be broader than the corporate concept of “materiality,” as it extends to determination of what could be material to each specific institutional investor. This duty to investigate is central to informed decision

making and contemplates creation of documents that show the basis for fiduciary decisions.

- **Prudence is Dynamic** – Prudence is not a static concept. The prudent standard of care evolves as facts, circumstances and knowledge evolve. Change is a constant natural process. Consequently, resilience and adaptation are necessary characteristics for forward-looking investment fiduciaries with long-term liabilities. A newfound appreciation of this concept forced fundamental changes in investment and legal frameworks for investor fiduciaries in the 20th century. This evolution occurred after it became evident that, over time, static legal lists of mandated and precluded investments limited adaptability and produced markedly lower returns than a dynamic whole portfolio approach.

UNDERSTANDING THE FIDUCIARY DUTY LANDSCAPE

The above investor fiduciary principles reflect the impact that market evolution and investor experience has had over centuries on the development of common law. The failure to recognize this past learning and apply the complete range of current investor fiduciary duty principles has skewed much of the recent policy debate and legal analysis toward a mirage. Context provided by the actual investor fiduciary duty landscape merits greater attention.

Duty of Loyalty Legal Context

The duty of loyalty is intended to protect fund participants from theft or misappropriation by the investor fiduciaries and from favoritism or diversion of trust fund assets to third parties or causes. Rules on prohibited transactions, ethics and standards of conduct are used to implement this duty. Given the opportunities for misconduct and the heavy reliance that trust fund beneficiaries place on investor fiduciaries for life savings or other large sums of money, loyalty standards are the strictest of all fiduciary duties. For example, corporate law grants company fiduciaries greater leeway to engage in transactions that involve conflicts of interest than is accorded to investor fiduciaries. Serving as an investor fiduciary is a unique role that is often misunderstood by people familiar with duties of apparently similar positions which actually have different standards, such as corporate directors, elected officials and other public officers.

Favoritism and diversion of assets to benefit third-party interests have been a recent focus of debate. The fiduciary principle involved is clear:

”Conduct in administering a trust cannot be influenced by a trustee’s personal favoritism . . . Nor is it permissible for a trustee to ignore the interests of some

beneficiaries merely as a result of oversight or neglect.” [Restatement of Trusts 3rd, §79, Comment b]

“[An ERISA fiduciary] may not sacrifice investment return or take on additional investment risk to promote benefits or goals unrelated to interests of the participants and beneficiaries in their retirement income or financial benefits under the plan.” [29 C.F.R. § 2550.404a-1(c)(1)]

The duty of loyalty does not distinguish between diversion of trust assets to promote liberal or conservative goals. However, it also does not preclude investor fiduciaries from pursuing ideas endorsed by only one side of the ongoing culture wars if a fiduciary determines the idea offers competitive investment opportunities that fit within the risk/return structure of a particular fund. The Uniform Prudent Investor Act explains why:

*“Subsection 2(e) clarifies that **no particular kind of property or type of investment is inherently imprudent**. . . . **The universe of investment products changes incessantly. Investments that were at one time thought too risky, such as equities, or more recently, futures, are now used in fiduciary portfolios. By contrast, the investment that was at one time thought ideal for trusts, the long-term bond, has been discovered to import a level of risk and volatility - in this case, inflation risk - that had not been anticipated**. . . . **The premise of subsection 2(e) is that trust beneficiaries are better protected by the Act's emphasis on close attention to risk/return objectives** as prescribed in subsection 2(b) than in attempts to identify categories of investment that are per se prudent or imprudent.” [Emphasis added], Uniform Prudent Investor Act §2(e), Comments.*

Legislation and court opinions that favor a preferred cause or establish per se prudent and imprudent investments run in direct opposition to the 20th century learning reflected in the Uniform Prudent Investor Act, Restatement of Trusts and related case law. However, there is another investor fiduciary duty principle to consider that also addresses favoritism and bias – the duty of impartiality.

Duty of Impartiality

The United States Supreme Court recognized that investor fiduciary duties include a duty of impartiality. When interpreting §§404 and 409 of ERISA, the Supreme Court cited the following common law principle as part of the foundation for its holding.

*“The common law of trusts recognizes the need to preserve assets to satisfy future, as well as present, claims and requires a trustee to take impartial account of the interests of **all** beneficiaries. See Restatement (Second) of Trusts § 183 (discussing duty of impartiality); *id.*, § 232 (same).” *Varity v. Howe*, 516 U.S. 489, at 514 (1996) [emphasis added].*

This common law of trusts principle referenced by the Supreme Court is currently set forth in the Restatement of Trusts, Third:

“The ‘Duty of Impartiality’ requires that fiduciaries identify and impartially balance conflicting interests of different trust fund groups, including current and future beneficiaries.” Restatement of Trusts, Third §79.¹

This duty of impartiality is of particular importance when investor fiduciaries manage assets across multiple generations of participants and beneficiaries or for an entity with perpetual existence – which is nearly always the case. For example, perpetual charitable organizations require investment strategies that build long-term wealth to ensure long-term viability. For pension funds, different generations are likely to have different risk tolerance levels and time horizons. The presence of both 25- and 75-year-olds amongst fund participants also raises the potential for uncompensated transfer of risks and returns between different generations. The duty of impartiality mandates careful consideration and good faith efforts to reasonably balance these risk tolerance and time horizon conflicts.

Investment Horizon Balance

Unfortunately, much of the current fiduciary duty debates seem to be focused on generation of short-term returns. This presents duty of impartiality compliance concerns for investor fiduciaries that must balance both short- and long-term obligations to fund participants and beneficiaries. The potential for uncompensated transfers of risk and returns from younger to older generations is a fiduciary problem. Research at the London School of Economics provides context for this issue.

*“The economics profession has also misunderstood the basics of discounting, in relation to, particularly, its dependence on future living standards. It means **economists have grossly undervalued the lives of young people and future generations . . .**”² [emphasis added].*

In addition, fixation on the short-term undermines the long-term competitive position of investee companies, which increases the risk of reduced long-term investor returns. Research has demonstrated that, over the long-term, companies managed toward a long-term horizon substantially outperform their peers that focus on short-term horizons.

“From 2001 to 2014, the revenue of long-term firms cumulatively grew on average 47 percent more than the revenue of other firms, and with less volatility. Cumulatively

¹ As noted above, the Restatement also emphasizes that fiduciaries cannot “ignore the interests of some beneficiaries merely as a result of oversight or neglect.” Restatement of Trusts, Third §79, Comment (b)

² Professor Nicholas Stern, speaking at the London School of Economics on [The Economics of Climate Change: The Stern Review](#) (October 2021)

the earnings of long-term firms grew 36 percent more on average over this period than those of other firms, and their economic profit grew 81 percent more on average.”³

Focusing Capital on the Long Term also highlights the competitive ramifications of this short-term focus for American companies.

*“2024 saw rising skepticism toward future-focused initiatives, often dismissed as too costly or uncertain in the face of immediate challenges. . . . While these efforts seem inconsequential to the bottom line in the moment, **the reality is that investing now for future growth is what will separate the winners over time.**”⁴*
[Emphasis added.]

The investor fiduciary obligation to consider long-term risks and opportunities reflects a similar principle in corporate law. In the corporate law context, Delaware state law (where 68% of Fortune 500 companies are incorporated⁵) imposes a fiduciary obligation on boards to manage companies for the long term (outside sale-of-the-company situations). For example, in the 2024 *McRitchie v Zuckerberg* Opinion, the court confirmed that Delaware’s fiduciary duty for corporate directors requires inclusion of a long-term perspective, consistent with use of a balanced long-term time horizon on the investor fiduciary side:

"The fiduciary duties owed by directors of a Delaware corporation require the directors to seek to maximize the value of the corporation over the long-term for the benefit of the stockholders as residual claimants to the value created by the specific firm that the directors serve."⁶ [Emphasis added.]

This consistency across corporate director and investment fiduciary long-term horizon responsibilities is important for efficient allocation of capital throughout the economy and to support the future competitive position of American companies. If policymakers or courts limit investors to short-horizon strategies, both companies and investors will suffer the consequences.⁷

³ Measuring the Economic Impact of Short-Termism, McKinsey Global Institute (2017), <https://www.mckinsey.com/featured-insights/long-term-capitalism/where-companies-with-a-long-term-view-outperform-their-peers>.

⁴ Letter from the CEO of *Focusing Capital on the Long Term* (January 2025) at <https://www.fcltglobal.org/resource/2024-letter-from-the-ceo/>.

⁵ Delaware Division of Corporations, Secretary of State, Annual Report Statistics, <https://corp.delaware.gov/stats/>.

⁶ See *McRitchie v. Zuckerberg*, page 74 at <https://cases.justia.com/delaware/court-of-chancery/2024-c-a-no-2022-0890-jtl.pdf?ts=1714494707>). In *Frederick Hsu Living Tr. v. ODN Holding Corp.*, the Delaware courts further held that “The fact that some holders of shares . . . prefer a higher near-term market price likewise does not alter the presumptively long-term fiduciary focus.” WL 1437308, 18–19 (Del. Ch. Apr. 14, 2017)

⁷ The authors recognize that geopolitical risks and uncertainty present at the time of writing this article may present what is hopefully a temporary roadblock to long-term planning.

Duty of Prudence Legal Context

The prudent standard of care is intended to protect fund participants from negligence and incompetence on the part of the agents who manage the fund's assets, which are often the participants' accumulated life savings. Peer practices are a reference point for evaluating the prudence of fiduciary conduct. However, prudence is not a "lemming" standard. Differences in funding status, time horizon, risk tolerance, stakeholders, statutory provisions and other factors preclude application of a *one-size-fits-all* approach. Prudence is also not intended to serve as a roadblock to adoption of improved practices or prevent consideration of evolving knowledge and circumstances. In fact, prudence is inherently forward looking. The word "prudent" comes from the Latin word meaning "to act with or show care and thought for the future."⁸ Investors with future liabilities simply cannot satisfy their duty of prudence by focusing only on the short term.

Prudence as a Dynamic Concept

Change is inevitable, and fiduciaries have a duty to implement processes that identify, evaluate, and respond to changing circumstances and knowledge. The Employees Retirement Income Security Act ("ERISA"), which governs private pension plans, references this principle. Section [404\(a\)\(1\)\(B\)](#) of ERISA, instructs fiduciaries to act "*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....*" Use of the phrase "***under the circumstances then prevailing***" contemplates paying attention to investment industry changes and improvements in peer practices, as well as evolution of real-world circumstances that could impact investment risks and opportunities over relevant time horizons which, for pension funds, includes the long-term.

Implementation of the duty to consider evolving knowledge and circumstances can be challenging. For example, there was a major transition in implementation of fiduciary duties that took place in the last half of the 20th century. It involved an evolution from legal lists of permitted investments to the application of Modern Portfolio Theory and transition from the "prudent person" to the "prudent expert" standard of care (using practices of similar expert investors rather than the common man as a reference point).

That shift in practice took several decades, leaving fiduciaries caught between two seemingly inconsistent investment approaches during the interim. One 1988 commentator

⁸ See Prudent, Oxford English Dictionary (3rd Ed. 2007).

described the tension during that transition as investor fiduciaries were being held back by outdated rules:

*"A fiduciary cannot behave as a careful, wise, discreet, judicious and prudent man if he acts within the strictures of a prudent man rule that forces him to behave imprudently in the contemporary economic marketplace."*⁹

In response to these late 20th century changes in the investment industry knowledge base, the following provisions were added to the Restatement of Trusts in 1992 to incorporate lessons learned from the transition:

"There are no universally accepted and enduring theories of financial markets or prescriptions for investment that can provide clear and specific guidance to trustees and courts." Restatement (Third) of Trusts, §227, Comment f

"Trust investment law should reflect and accommodate current knowledge and concepts. It should avoid repeating the mistake of freezing its rules against future learning and developments." Restatement (Third) of Trusts, §227 Introduction

It appears that the investment industry and world economy are now in the midst of a similar period of transitions. Policymakers and courts should recognize that adaptation to evolving circumstances is a core investor fiduciary duty.¹⁰ Inflexible statutory investment mandates, once enacted, can prevent investor fiduciaries from responding to market changes for decades and, as was discovered in the late 20th century, result in unwanted retention of risky holdings while blocking access to new opportunities.

Duty to Investigate Relevant Facts

The duty of prudence also includes a requirement that investor fiduciaries investigate and verify facts that are relevant to investment decisions. For example, the Uniform Prudent Management of Institutional Funds Act requires that fund managers *"make a reasonable effort to verify facts relevant to the management and investment of the fund."*¹¹ Documentation of fact finding and decision making is also important as a means of demonstrating compliance with fiduciary standards.

An official Comment to the Act explains: *"This subsection incorporates the traditional fiduciary duty to investigate . . . The subsection requires persons who make investment and*

⁹ [Review by Lynn Nichols of 'Modern Investment Management and the Prudent Man Rule'](#), The Business Lawyer Vol. 43, No. 2 (February 1988), pp. 779-786.

¹⁰ For a more extensive history of evolution in the application of fiduciary duties, see Paul G. Haskell, [The Prudent Person Rule for Trustee Investment and Modern Portfolio Theory](#), 69 N.C. L. Rev. 87 (1990).

¹¹ The [Uniform Prudent Management of Institutional Funds Act](#), section 3(c).

management decisions to investigate the accuracy of the information used in making decisions.”

For institutional investors with long-term obligations, this includes investigation of facts relevant to both short- and long-horizon decisions. It also contemplates consideration of how fund investment practices of portfolios in one asset class might affect risk and return in other fund asset class portfolios – for example, how short-term risk and return strategies in public equities could affect risks borne by long-term bonds in the fund’s fixed income portfolios.

Imposition of an inflexible, “*one size fits all*” short-term approach that limits the freedom of investors to consider long-horizon obligations and use forward-looking processes and investigate all relevant facts is unlikely to end up serving the best interests of fund participants, especially as circumstances change over time. Policymakers and courts should tread carefully when considering mandated short-horizon only investment practices that ignore lessons of the 20th century. Investor fiduciaries and companies need the freedom to adapt in order to succeed in the face of inevitable future changes in knowledge and circumstances.

CONCLUSION

Decisions by policy makers and courts should be made with a full understanding of the facts and legal principles being debated. Unfortunately, many of the ongoing culture war debates involving investor fiduciary duties are being fought with a limited understanding of what is being considered. Legal principles that have often been ignored include the (a) intergenerational duty of impartiality between participant groups with conflicts of interest, (b) forward-looking process framework required for investor fiduciary decisions, (c) obligation to investigate “relevant” facts and (d) dynamic nature of the prudent standard of care. In addition, there has been almost no recognition of lessons learned during the last half of the 20th century about the dangers of denying investor fiduciaries the flexibility to adapt to evolution of markets, knowledge and real-world circumstances.

The financial security of millions of American workers and savers, as well as the future competitive position of American companies in the global marketplace, depend on policy makers and courts recognizing how all pieces of the investor fiduciary duty puzzle fit together. Decisions based on a partial picture of the fiduciary duty landscape are unlikely to turn out well over the long term for American workers, savers and companies.