Conversations with the next gen: the big picture in private wealth

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It is around 20 years since the term "ESG" was first coined in a UN report, but it is only over more recent years that the concept has gathered significant momentum. [1]

In its latest report, published to coincide with COP28 in Dubai, for example, the Global Sustainable Investment Alliance (**GSIA**) found that US$30.3 trillion is currently invested in sustainable assets globally, with non-US markets – Canada, Europe, Japan, Australia and New Zealand – in particular showing a 20% increase in sustainable assets under management (**AUM**) since 2020. [2]

Some have argued that this is a result of a generational change, with the next gen being more focused on their money "doing good" as well as growing through investment. However, in reality, the trend is more nuanced. It is hard to believe that, as a general rule, the next gen is inherently more socially and environmentally conscious than their predecessors.

In practice, the ESG movement is linked to numerous macro trends – such as greater social acceptance of data transparency, post-pandemic awareness of rebuilding economies sustainably, the importance of diversity and inclusivity, and a desire to embrace progress through digital innovation – and is facilitated by increased reporting on and availability of ESG data on potential investments.

Environmental, social and governance considerations are not "next gen" issues, per se, but it is the next gen that is now charged with navigating them. With 70% of families identifying a greater role for the next gen in family office activity in the coming years, the next gen is carrying the baton at a time of considerable and accelerated wider change, coinciding with mass transfer of intergenerational family wealth. [3]

The question becomes, then, not so much about the next gen **driving** the ESG movement, but more about how they are **managing** that movement, as the custodians of future wealth.

For trustees charged with supporting families with wealth and succession planning and family governance, there are clear implications when it comes to structuring for wealth preservation and growth for dynastic families and balancing the ESG ambitions of that family with their duties as trustees to beneficiaries.

Duties

The ESG movement is undoubtedly more than just a trend. ESG is now key to helping stakeholders understand how an organisation manages risks and opportunities around sustainability issues, diversity and inclusion and responsible governance practices. While 20 years ago, it would have been unlikely that discussions around sustainable finance, green funds, and ESG would have been on the agenda for families, the next gen has grown up surrounded by this narrative.

In a study undertaken by Wealthbriefing, for example, next gen family members placed a greater weighting on the importance of ESG principles (63%) than pure financial return (37%). The founder generation, meanwhile, was the exact opposite – 33% to 67%. [4]

And it is this subtle interplay between the perceived ESG-driven ambitions of the next gen and the existing objectives of the current asset holding structures that is cause for real consideration among trustees, specifically in relation to their fiduciary duties.

Trustees always need to be ready to adapt, but in a way that continues to meet their duties to act in the best interests of their beneficiaries and to act as "prudent" investors of trust assets. The integration of ESG thinking into all areas of family wealth management – from structuring to due diligence, to risk management to investment and reporting – is changing the conversations between families and their trustees.

There are conversations to be had, for instance, around what ESG actually means to a family. ESG can be a broad set of investment parameters and part of a risk management framework focussed on generating returns, so firmly in the domain of the investment manager, but it is also an approach with ideas of social responsibility and morality at its heart. This all means there needs to be a renewed focus on what relevance ESG has to a particular family and what financial and / or ESG outcomes are being sought by that family, balanced alongside trustee investment powers and duties to beneficiaries.

From an investment perspective, the go to reference point for trustees for decades has been the need to "yield the best financial return for the beneficiaries". The growing focus on ESG, however, has challenged the interpretation of this, in cases where wanting to pursue a strategy of delivering environmental or societal benefit may not enable the realisation of the best possible financial return. That is not to say adopting an ESG investment strategy must be to the detriment of financial return or even at odds with fiduciary duties.

It is arguable, that the "prudent" fiduciary's response points to the long-term value of pursuing an ESG strategy, championing the idea that in the longer term not pursuing a strategy which takes into account or is focused on delivering positive impact would not be the prudent thing to do.

In exercising their powers of investment in relation to the trust fund it is critical that trustees uphold their key duties, in particular, to act in the best interests of beneficiaries.

That thought process throws up questions around what is in the interests of the current generation, and, against a long-term time horizon, what is in the interest of the next generation, and future generations after them. This is particularly relevant where trusts have long, or even unlimited, trust periods and investment horizons can span decades to meet the needs of future generations.

It is a fine balancing act, and sound investment as well as legal advice for trustees is key, around questions such as:

- what is the scope of the trustee investment powers and are they subject to any limitations?
- are they properly exercising their powers as a trustee and how can they demonstrate this?
- what does this mean in terms of benefit and financial benefit?
- is the investment strategy sufficiently diversified to demonstrate prudence?
- are definitions around ESG and desired outcomes clearly defined and understood by the trustee and the family / beneficiaries?
- does investing with only an ESG strategy or with a social impact goal potentially conflict with other duties?

Understanding ESG criteria and ESG and sustainable investment terminologies is important in understanding what the family wants to achieve and how this fits within the scope of a trustee's powers under the trust deed and duties. If left undefined this can cause uncertainty and misunderstanding between the trustee and the family as to the investment outcomes sought. Ultimately, trustees need to have a full, rounded picture built on data and facts if they are to make well-reasoned decisions.

Structures

Of course, this all has an impact on structuring. Effective structuring can provide the framework to both empower families and enable trustees to carry out their duties effectively.

Whether an existing structure will be appropriate for adaptation to "fit" ESG goals, for example, is an increasingly common question. An existing structure may have been set up as a traditional "dynastic" trust to benefit multiple generations of a family and grow a family's wealth, not to drive social or environmental change. It is a challenge for a trustee to be thinking about social impact in such circumstances, because then they would either be choosing to benefit society over beneficiaries or having to evidence clearly that the "return" was a social or environmental impact.

That is not to say it is impossible – there is case law that supports that acting in the best interest of beneficiaries isn't just about their financial benefit, but it can certainly be a challenge to demonstrate how something that is not in their best financial interests is still for a person's benefit. Financial benefit and demonstrating return has historically been and continues to be the primary way of evidencing that a trustee is acting in the best interests of its beneficiaries. Where beneficiaries feel moral responsibility towards driving positive societal and environmental change or feel morally obliged to ensure that the family wealth is being generated and reinvested in a socially responsible manner, it is potentially more difficult to evidence how investing with such goals is for their benefit (even though arguably it is) if financial return cannot also be demonstrated. The risk to a trustee is that if there is less return or a loss to the trust fund as a consequence of taking a particular investment decision based solely on beneficiary's moral position. The trustee might find itself open to attack from other beneficiaries (whether current or future) who may not feel the same way and, at worst, personally liable for that loss.

Equally, making amendments to existing structures to permit trustees to put social or philanthropic objectives ahead of the interest of the family beneficiaries and to seek to relieve trustees from their duties to those beneficiaries in itself could be a breach of trust, again, putting the trustee at risk of future generations accusing them of not carrying out their duties properly.

It may be, therefore, that advisers need to consider alternative or new structures specifically designed to meet these social, environmental, or philanthropic aims that current structures may not already cater for and balance these, crucially, against the legal need for the trustee to be "prudent" in its investment decision making.

When it comes to new structures, certain things can be incorporated at the outset, for example, express permissive wording around how trustees exercise their investment powers, taking into account ESG considerations. The use of reserved investment powers is also possible, where a settlor reserves a certain power at the outset to direct the trustee, with a view to enabling ESG investments that are less likely to have a financial return. Bespoke structuring targeting very specific outcomes is also possible, particularly on the philanthropic or social impact side, often using non charitable purpose trusts or foundations.

When discussing ESG and sustainable investing, it is also important to understand the terminology and make the distinction between the different approaches. Whereas ESG and sustainable investment criteria can be applied to selecting and monitoring investments but still with an eye on financial return, social impact investing to drive positive change or with philanthropic aims are different and have different end goals which may require bespoke structuring to achieve their objective. Impact investment and philanthropy aims do not sit easily within a dynastic discretionary trust environment which is intended to financially benefit multiple generations of a particular family but not society at large.

In all cases, there are potential structuring solutions but these need to be carefully balanced, informed by proper investment advice and in accordance with existing fiduciary duties.

New thinking

Evolution in the ESG landscape is undoubtedly set to have a significant impact on the transfer of mass wealth over the coming years. It provides a unique opportunity to instil new thinking within a family for multi-stakeholder engagement; establish formal frameworks around investment, impact, and philanthropy; and provide the foundation for effective succession planning.

But this needs to be accompanied by an understanding of the structure through which the investments are being made to find a balance between wealth ambitions, existing "dynastic" objectives and emerging goals linked to sustainability, inclusivity and equality, and governance.

For trustees, balance is key. By being proactive and clear around duties and investment powers, trustees can help guide families through a complex landscape. Being able to discuss openly what families want to achieve in this area, particularly around nebulous concepts like "impact" and "purpose", is vital if trustees are to demonstrate that they have exercised their investment powers and fiduciary duties properly.

[1] Read the article by Euromoney - The United Nations free-thinkers who coined the term "ESG" and changed the world

[2] Read the 2023 GSIA report - Global Sustainable Investment Review finds US$30 trillion invested in sustainable assets

[3] Read the 2022 report by Jersey Finance and Family Capital - Family Offices and Investment: The Generation Shift

[4] Read the 2021 report by Wealthbriefing and Jersey Finance - Virtuous Circles: Sustainable Family Governance Models in an Evolving Environment

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