Sustainable investment and the role of the fiduciary

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What is the issue?

The march of sustainable investing has given trustees a tricky balancing act to tread in terms of meeting their multifaceted duties as trustees.

What does it mean for me?

Integrating sustainable investments into a trust investment strategy is not necessarily straightforward and trustees must understand what sustainable investment means, regarding legal responsibilities to the trust, beneficiaries and, more widely, society.

What can I take away?

Practical and philosophical considerations for trustees that can help them balance their sometimes-conflicting duties in the context of the emerging area of sustainable investment.

Sustainable investing is generating a lot of interest, as it caters to the needs and desires of younger generations and baby boomers alike. In particular, global transparency is focusing clients' minds more on the responsibility that wealth brings and, on the flipside, the potential for large-scale reputational risk if this is ignored.

In the world of investment, there is growing momentum for change, with investors calling for their money to make a positive impact on society and the world at large. That said, by only investing in sustainable companies, fiduciaries are narrowing their investable universe, and trustees must balance long-term concerns around sustainability with their more immediate responsibilities to beneficiaries.

Different approaches to sustainable investments bring different degrees of investment risk and one of the biggest challenges for trustees is the absence of universally recognised guidelines for sustainable investing.

Trustees' duties and investment powers

Investing is an area where trustee powers and obligations in respect of trust property come to the fore.

The powers and duties of a trustee in Jersey, for example, derive from three main sources: the *Trusts (Jersey) Law 1984* (the **Law**), customary/case law and the terms of the trust. Generally speaking, the powers of investment are wide, with art.24(1) of the Law stating that a trustee of a Jersey trust shall enjoy all the same powers as a natural person acting as the beneficial owner of such property. However, this power is tempered in two regards, the first being that the trustee may only exercise such powers in the interests of the beneficiaries and, secondly, in accordance with the terms of the trust.

When it comes to the choice of investments, it is worth remembering that under the general duty of care expressed in art.21(1) of the Law, the draftsman seemed to have in mind the ordinary, prudent businessperson under English law.[1] The principle is neatly summarised by Lindley LJ in the England and Wales Court of Appeal case of *Whiteley v Learoyd*:[2]

> *'The duty of a trustee is not to take such care only as a prudent man would take if he had only himself to consider, the duty rather is to take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide.'*

It is the need for prudence that means the sustainable investing capabilities of banks and investment managers should not be presumed. There must be careful analysis as to how they come to their conclusions about the balance of a portfolio.

This is particularly the case in light of the other core duties of a trustee, concerning the preservation and enhancement of the value of trust property, as far as is reasonable.

Sustainable investing: choice of investments

Can sustainable investing play a major role within a trustee's portfolio? This is not necessarily a straightforward question.

Historically, there were arguments that they could not, which largely stemmed from cases such as *Cowan v Scargill*.[3] Here, the trustees of the National Coal Board pension fund had£3 billion in assets. Five of the 10 trustees were appointed by the Board and the other five were appointed by the union, led by Arthur Scargill.

Under a new *Investment Strategy and Business Plan 1982*, the union wanted the pension fund to:

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This was all intended to enhance the mines' business prospects. The trustees refused to adopt this approach and they ended up in court.

In his judgment, Megarry VC held the trustees would be in breach of trust if they followed the instructions of the union, saying ‘the best interests of the beneficiaries are normally their best financial interests’. So, if investments of an unethical type ‘would be more beneficial to the beneficiaries than other investments, the trustees must not refrain from making the investments by virtue of the views that they hold’.

It was not until 2014, that the Law Commission of England and Wales commented that the case should not be seen as precluding trustees from taking account of ESG factors when making investments. That said, given a trustee's duty to diversify, and act prudently and in the best interests of the beneficiaries, trustees may still be reluctant to invest sustainably without added protection.

So, what can a trustee do to mitigate the risks if sustainable investing is to be a primary concern of any portfolio?

Mitigating risk: discretionary trust

Specific provision

With a standard discretionary trust, the starting point should be its terms. Specific provision should be included in the trust instrument that the trustee has the power to invest in sustainable investments.

Consideration should also be given to recording the expectations around the extent to which the trustee will invest in such products.

Prescribed direction

Express prescribed direction provisions in the trust terms, which reserve the ability of the settlor or another person to direct the trustee, may also be helpful.

Article 9A of the Law provides that a trustee acting in accordance with any direction given would not be acting in breach of trust. That said, the existence of prescribed directions provisions does not absolve the trustee from all obligations and duties in respect of the investment of trust assets. In addition, it could be argued that there is also a general ongoing duty to monitor the performance of the investments made, pursuant to the prescribed directions.

The trustee’s position can be likened to being on a ship, where the person giving the prescribed directions (normally the settlor) is at the helm. Though not at the helm, the trustee must remain on the bridge and monitor what the power holder is doing. If they are setting a course direct for rocks (perhaps a lot of ‘all or nothing’ investments, more akin to gambling than investment), then the trustee has a duty to go to court to try and gain control of the helm and avert the impending disaster.

Mitigating risk: other solutions

Unlike traditional trusts, purpose trusts do not have beneficiaries. Instead, they are established for specified non-charitable purposes. A ‘purpose’ is defined in the Law as ‘any purpose whatsoever’. Such purposes could be broad for ‘social and environmental impact investing’ or more specific, such as ‘for the advancement of renewable energy assets’.

Foundations are also a fairly obvious option. Foundations can be particularly useful where a structure is required to hold assets whose value is volatile or may diminish. The council of the foundation will not be subject to the same duties as a trustee in a traditional trust; rather, their duty will be to ensure the objects of the foundation are achieved.

Philanthropy

Private clients with a new approach to investment commonly look to align this with their philanthropic aspirations in order to achieve real value and impact. This development is indicative of clear concerns surrounding recent scandals in the charitable sector, alongside the influence of cultural philanthropic strategies seen around the world from, for example, the likes of Mark Zuckerberg and J K Rowling.

Advisors can add value in the highly bespoke nature of the structures they set up for their clients, which look to help articulate the client's beliefs, values and objections. Charitable trusts, purpose trusts and foundations all lend themselves well as philanthropic structures.

Charity

The introduction of the Jersey Charities Register in May 2018 under the *Charities (Jersey) Law 2014* helps by providing a framework by which charities in Jersey are regulated, with a Commissioner overseeing its maintenance and enforcement. This helps with reputational risk concerns.

Conclusion

With social, economic and political change shifting the expectations and requirements of beneficiaries, the role of fiduciaries has become correspondingly complex.

On the one hand, trustees have legal responsibilities that set the bar high in terms of how the assets of a trust are managed; on the other, the drive towards sustainable investment only looks set to gain more momentum. Balancing the two is something that trustees will increasingly be called upon to do.

[1] For the purposes of this article, all references to the law of England and Wales will be shortened to ‘English law’.

[2] (1886) 33 Ch.D. 347

[3] [1985] Ch 270

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Meet the Author

Henry Wickham

Partner

Jersey

E: henry.wickham@ogier.com

T: +44 1534 514291

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