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Should trustees be worried about global warming

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Climate change will no doubt continue to be a worldwide topic of concern and will impact us all. The science is clear and reinforced by the extremity and increasing frequency of recent climate-related disasters such as typhoons, flooding, drought and, of course, the tragic wild fires in Australia. If that sounds alarmist, remember that in 2018 California had the deadliest forest fires in its history while over 100 people died in wild fires in Greece.

BlackRock, the world's biggest fund manager, has put climate change and sustainability at the heart of its strategy, doubling the number of green funds it invests in and curtailing its investments in coal companies. 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.

Can trustees invest to address the threat of climate change?

Generally speaking, a Jersey trustee's powers of investment are wide, with article 24(1) of the Trusts (Jersey) Law 1984, as amended (the Trusts Law) stating 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. Historically, the best interests of beneficiaries have been considered their best financial interests.

If a settlor, when establishing a trust, wishes for the trustee's investment outlook to be bound by concerns about the climate then the trust instrument can be adapted accordingly. For example, certain express provisions can be included prescribing an investment outlook which is sensitive to carbon emissions.

Alternatively, the settlor can reserve certain powers to direct investments as set out in the Trusts Law. Article 9A of the Trusts Law provides that a trustee acting in accordance with any direction given would not be acting in breach of trust. This could, for example, assist with mitigating the risk for a trustee in respect of ESG or impact investing which may lead to below-market returns.

If beneficiaries of an existing standard discretionary trust, without the kind of bespoke provisions referred to above, approach a trustee requesting their investments do not contribute to global warming, then the trustee will need to carefully consider such requests in the context of their investment duties. When it comes to the choice of investments, it is worth remembering that under the general duty of care expressed in Article 21(1) of the Trusts Law, the draftsperson seemed to have in mind the ordinary, prudent business person. In other words, the trustee should take care as an ordinary prudent person would take if they were minded to make an investment for the benefit of other people for whom they felt morally bound to provide.

The starting point is that there is no absolute duty as to what you should or shouldn't invest in. Consistent with the prudent investor is the emphasis on good process which, in the context of addressing the risk of climate change, means the trustee using a framework to evaluate climate risk in terms of its investments.

Does focusing on climate change necessarily have a detrimental effect upon the investment performance of a trust fund?

It is often assumed that an investment strategy that takes into account environmental factors will not be as lucrative. However, more and more financial forecasts are pointing towards climate change as being not only an ethical issue but a pure financial consideration for trustees.

A 2018 Cambridge University study suggested $1-4 trillion of value could be lost from the global economy in the next couple of decades from fossil fuel assets alone. In addition, the Bank of England has started paying attention to the problem of "stranded assets", or investments in carbon-intensive assets and industries that risk being caught in a downward spiral of falling valuations and fire sales. The Bank of England has estimated as much as $20 trillion of assets may be at risk of stranding and has proposed climate-related stress tests for banks and insurers.

What are the other risks posed by ignoring climate change?

People are increasingly wanting to understand how their money is being invested and that such investment is consistent with stabilising the climate. As an industry we have always strived to maintain the highest standards of professionalism. A potential risk is that trustees are held accountable in the future for not taking into account climate change as a relevant consideration in their actions when acting in the best interests of beneficiaries.

A pragmatically broad concept of benefit has be taken in the authorities in connection with the exercise of trustee's dispositive powers under a trust. It includes being able to take into account a beneficiary's moral wellbeing. It is not that much of a stretch of the imagination seeing such an analysis being applied to investments.

What steps should trustees be taking?

So if a trustee deems it in the best interests of the beneficiaries to decarbonise their investment strategy what steps should it be taking? The standard for judging whether a duty has been breached under the Trusts Law is that of a reasonable trustee.

Therefore, there is no automatic liability if, with hindsight, the wrong decision was reached when deciding whether to invest if, at the time of such investment, the trustee acted reasonably. The courts accept that there is not always one way for a trustee to act. However, given the law's emphasis upon trustees' actions being viewed through the lens of investment performance it is recommended that trustees carefully record the considerations that have been taken into account in giving weight to climate risk in determining investments.

How should the trustee identify its asset strategy?

When dealing with investments, typically a trustee will delegate the functions of administering assets to an investment manager. It is good practice to have an investment policy statement in place from the outset of any delegation. Such statement will be particular to the trust in question taking into account the needs of the beneficiaries and the attitude to risk.

If appropriate, trustees should include in their statement their broad-based concerns about climate change and its potential impact on the performance of the trust assets. A policy of socially responsible investing may be adopted whereby pollutant stocks or potential stranded assets are actively eliminated. Alternatively, an approach may be adopted whereby it is insisted that the investment manager applies a climate risk overlay in terms of stock analysis.

Noting the continuing duty to monitor the performance of the investment manager under the Trusts Law any statement should be regularly reviewed in the context of performance. If the statement remains unchanged, it would be prudent for that to be noted accordingly, so that files record the fact that the trustees considered the matter.

Implementation

The trustee will need to determine how proactive it wants to be and what actions it will accordingly take. The degree of concern over the impact of investments on climate change may alter with the development in technology, generational changes, or even just changes in the beneficiaries' circumstances.

Therefore it would seem prudent to recommend an incremental approach to implementation to evaluate the effectiveness of the strategy and recognising that further steps may be taken over time as necessary. Furthermore, it would seem prudent not to completely ignore businesses which may well currently have a relatively high carbon footprint but which are high-performing and are developing clear solutions to carbon emissions.

Conclusion

It's talked about the 20s being a critical decade in tackling global warming. There will almost certainly be more disclosure about what fiduciaries are doing and people will increasingly want to know how their money is invested. Whilst there has undoubtedly been a lot of take up in terms of corporates and asset managers making climate related financial disclosures there is likely to be an ever stronger spotlight on real actions taken in terms of, for example, negative screening or formal divesting of carbon related assets. Arguably, there is a heightened duty for trustees to consider climate change issues actively as a matter of course from a fiduciary perspective. As a forward-thinking jurisdiction, Jersey has been active in sustainable finance for some time. Being a jurisdiction with a wide range of flexible structures and with the knowledge, expertise and international relationships to support them, the Island is well placed to ensure settlors and trustees make the right choice to suit an investment outlook bound by climate risk concerns.

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