

# STEP JOURNAL

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## FAMILY BUSINESS

The latest trends impacting family businesses worldwide

## CAREERS

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The latest trusts and estates developments in Canada and the US



# Turning over a new leaf

FROM VIDEO WITNESSING TO DIGITAL WILLS,  
CANADIAN PROVINCES ARE MODERNISING  
THEIR TRUST AND SUCCESSION LAWS

## KEY POINTS

## What is the issue?

A recent England and Wales High Court decision sets out revised legal principles that describe the investment duties and powers of charity trustees.

## What does it mean for me?

The judgment provides guidance for trustees of charitable trusts wishing to align investments with their charitable purposes.

## What can I take away?

Trustees with discretionary investment powers must consider all materially relevant factors in making investment decisions in accordance with the trust's terms.

# Investing with purpose



## ASHLEY FIFE AND GINA PEREIRA REVIEW A LANDMARK JUDGMENT THAT SETS OUT REVISED LEGAL PRINCIPLES ON INVESTMENT DUTIES AND POWERS OF CHARITY TRUSTEES IN ENGLAND AND WALES

Businesses and investors are increasingly considering relevant environmental, social and governance (ESG) factors. However, trust law may not have kept pace with this phenomenon. How can trustees navigate this friction when investing in trust funds? A recent judgment provides guidance for trustees of charitable trusts wishing to align investments with their charitable purposes.

In *Butler-Sloss and Ors v Charity Commission for England and Wales and Anor*,<sup>1</sup> the England and Wales High Court (the Court) blessed the charity trustees' decision to adopt investment policies that restricted investments to those aligned with the charities' purposes, thereby excluding many potential investments. In so doing, the Court provided clarification regarding *Harries v Church Commissioners for England*.<sup>2</sup>

### THE CHARITIES

The Ashden Trust and the Mark Leonard Trust (the Trusts) were part of the Sainsbury Family Charitable Trusts network. The Trusts held assets

of significant value. They had been established for general charitable purposes; however, the trustees subsequently decided to principally pursue the purposes of environmental protection, the prevention and relief of poverty and those in need.

The Trusts' terms provided the trustees with broad investment powers in addition to statutory investment powers. The terms did not restrict the investments the charities could make.

### THE AIMS AND DEVELOPMENT OF THE INVESTMENT POLICIES

The financial objective of the investment policies was to generate capital growth exceeding inflation over the long term, while generating a sustainable spending level to support the Trusts' ongoing grant making. With the objective of reducing a direct conflict between the charities' purposes and their investments, the trustees sought to exclude, insofar as possible, investments that did not align with the Paris Agreement.<sup>3</sup> The trustees wished to pursue such policies even if financial returns might consequently not be maximised. The trustees worked carefully with appropriate specialists to develop detailed investment policy statements, guidelines and portfolio allocation.



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The investment guidelines effectively excluded over half of publicly traded companies and about 20 per cent of the total investible universe. Nevertheless, the investment policies' targeted investment return was 4 per cent above the consumer price index over five-year rolling periods (consistent with published rates of return of other large charities), with the managers expected to outperform relevant Paris Agreement and ESG investment benchmarks. The trustees conceded that any financial detriment to the charities of implementing the investment policies could not be fully assessed presently, but believed that there would not be any material long-term adverse financial impact on the Trusts.

### COURT APPLICATION AND ISSUES

The application was principally a category two *Public Trustee v Cooper*,<sup>4</sup> whereby the trustees sought the Court's blessing of their decision to implement the proposed investment policies. The Charity Commission of England and Wales (the Commission) and the Attorney General for England and Wales opposed the application, asserting that a Court determination was premature because the trustees had not properly considered the risk of financial detriment to the charities from implementing the investment policies. They asserted this was reflected by an absence of documentation, including minutes, detailing reasons for the trustees' decisions.

Consequently, the Court explored how charity trustees should balance the risk of making investments contrary to the charity's express purposes (and thereby potentially risking the loss of stakeholder support) against financial detriment caused by adopting an investment policy aligned with the charity's purposes, dismissing other investment classes.

### HOW SHOULD CHARITIES APPROACH CONFLICTS BETWEEN THEIR PURPOSES AND INVESTMENTS?

In respect to charity trustees' duties when balancing conflicts between the charities' purposes and investments, the Court considered the Commission's publication *Charities and Investment Matters: A guide for trustees* (the Guide)<sup>5</sup> and *Harries*.

The Guide contains a summary of the Commission's understanding of the relevant law relating to charities' investments based on its interpretation of *Harries*. The case explored situations where charities' trustees might forgo financial investment returns, provided that would not risk significant financial detriment to the charity. These situations include direct conflicts with the charity's objects and indirect conflicts that might alienate donors or otherwise reduce

support for the charity. The Guide considers whether a charity can 'decide to make ethical investments'<sup>6</sup> and confirms so where:

- A particular investment conflicts with the charity's aims.
- The charity might lose supporters or beneficiaries if it does not invest ethically.
- There is no significant financial detriment to the charity.

The Court concluded that *Harries* did not determine there was an absolute legal prohibition against charities making investments that directly conflict with the charities' purposes.

Consistent with the Guide, the Court accepted that charities may invest ethically, even if the investment might provide a lower rate of return than other investments. The Court agreed that a charity's trustees must be able to justify why it is in the charity's best interests to restrict investments.

### KEY LEGAL PRINCIPLES

The Court summarised key principles regarding charity trustees' consideration of ethical factors when investing:

- **Source of powers:** Trustees' investment powers derive from the trust instruments and statute.
- **Primary duty:** Charity trustees' primary overarching duty is to further the charity's purposes. Trustees must exercise their investment powers to further those purposes.
- **Risk-adjusted financial return:** Furthering charitable purposes is normally achieved by maximising financial returns on investments.
- **Social, impact or programme-related investments:** These are made using different powers than the pure power of investment.
- **Prohibition under governing document:** Where specific investments are prohibited under the governing document, they cannot be made.
- **Conflict with purposes:** Where trustees reasonably consider that investments potentially conflict with charitable purposes, the trustees have a discretion as to whether to exclude such investments. Trustees should exercise that discretion by reasonably balancing all relevant factors, including the likelihood and seriousness of the potential conflict and the probability and severity of any possible financial effect of excluding such investments.
- **Risk of losing support:** When considering the financial effect of making or excluding certain investments, the trustees can assess the risk of losing support from donors and damage to the charity's reputation.
- **Purely moral grounds:** Trustees

need to be careful if investing on strictly moral grounds outside of the purposes, as there may be differing views among the charity's supporters and beneficiaries.

- **Trustees' duties of investment:** Trustees are required to act honestly, reasonably (with all due care and skill) and responsibly in formulating an appropriate investment policy for the charity that is in the best interests of the charity and its purposes. Trustees need to exercise sound judgement by balancing all relevant factors, particularly the extent of the potential conflict against the risk of financial detriment.
- **Balancing exercise:** If that balancing exercise is properly done and a reasonable and proportionate investment policy is adopted, the trustees have complied with their legal duties. They cannot be criticised, even if the Court or other trustees might have come to a different conclusion.

### OBSERVATIONS

The *Butler-Sloss* decision clarifies the duties of charity trustees when adopting ethical investment policies. Its principles apply to charities with different and wide-ranging charitable objects. Notably, the Court accepted the trustees' carefully considered expert advice when formulating restrictive environmentally friendly investment policies and determining their financial impact.

The decision does not support trustees adopting purely moral views when investing. The Court indicated trustees should be mindful that not all beneficiaries will have the same moral stance. Maximising financial return remains the starting point.

Questions include: will the *Butler-Sloss* decision be influential outside the charities context, such as in the pension context or a dynastic private family trust? Would trustees benefit from trust instruments or statute granting specific powers permitting or requiring consideration of ESG factors when investing trust assets?

Trustees with discretionary investment powers must consider all materially relevant factors in making investment decisions in accordance with the trust's terms, including ESG factors that may have a material impact on financial performance.

### #CHARITIES #INVESTMENT #TRUSTS

<sup>1</sup> [2022] EWHC 974 (Ch) <sup>2</sup> [1992] 1 WLR 1241 <sup>3</sup> The Paris Agreement is an international treaty on climate change. The principal goal of the Paris Agreement is to limit global warming to well below 2°C above pre-industrial levels, and preferably to 1.5°C. The Paris Agreement does not attempt to identify what investments are or are not aligned with it. <sup>4</sup> [2001] WTLR 901 <sup>5</sup> Published 2011, last updated 1 August 2016. <sup>6</sup> i.e., in a way that reflects the charity's values and aims.