

# Trustee Responsibilities and ESG: Identifying Opportunities, Mitigating Risk and Finding Consensus

## Foreword – David Postlethwaite, Sustainable Finance Lead, Jersey Finance

The rapid evolution of sustainable finance has brought ESG investing<sup>1</sup> into the mainstream for private client advisers. Whilst the movement provides significant opportunities for the sector and underlying clients, it also presents a number of challenges and complexities in terms of the alignment between fiduciary duties, private wealth structuring and strategic approaches to sustainable investing.

As the world rebuilds from a pandemic and with the great wealth transfer already in motion, integrating ESG as a core concept into fiduciary businesses is increasingly seen as critical.

Building on those themes, Jersey Finance is delighted to publish this summary which captures the insights and perspectives of a global range of experts, brought together by Jersey Finance for a seminar in March 2022 as part of a wider week of events to mark the first year of our sustainable finance strategy, Jersey For Good – A Sustainable Future.

A full video recording of this seminar, Sustainable Finance: A Focus on ESG and Trustees, along with slides and speaker profiles, is available to view on our dedicated Event page.

*“Empirical and academic evidence demonstrates that incorporating ESG issues is a source of investment value. ESG analysis assists investors to identify value-relevant issues. Neglecting ESG analysis may cause the mispricing of risk and poor asset allocation decisions and is therefore a failure of fiduciary duty.”*

UN PRI, “Fiduciary Duty in the 21st Century”, 2019

<sup>1</sup> “ESG” stands for Environmental, Social, and Governance, representing a set of non-financial factors that investors are increasingly building into their analysis process to identify material risks and growth opportunities. These factors are also being used as a way of assessing the corporate sustainability credentials of businesses.

## Global Perspectives

The evolution of ESG investing is being driven on a number of fronts – by clients whose strategies are being informed more and more by a sense of purpose relative to profit and returns, by firms who are conscious of the need to embrace sustainability as part of their supply chain, and through the introduction of new policies from governments who are alive to the need for urgent action on ESG issues, and on climate change in particular.

We are only at the beginning of policy and regulatory action, and much more activity is expected in this space over the coming years. Most recently, the COVID-19 pandemic has strengthened the role of financial actors in supporting both a low carbon and more socially cohesive world, and what has become clear is that financial centres like Jersey stand to play a key role in transformation, acting as natural hubs for pooling capital and bringing together different market participants offering a wide range of expertise.

What is also clear is that there is a real need for sustainable finance solutions as part of the global recovery from the pandemic. Stephen Nolan, Managing Director of the UN-hosted Financial Centres for Sustainability (FC4S) network, points to the growing urgency of mobilising capital to meet sustainable development challenges.

Pre-pandemic, for instance, the annual financing gap for the UN’s Sustainable Development Goals (SDGs) stood at US\$2.5 trillion. It now stands at US\$4.2 trillion.

COP26 made it clear too that collaborative efforts are critical in meeting this demand for capital. Government and institutional capital must come together to bridge the gap, but it is also imperative that private capital is deployed. This has significant implications for private client advisers, trustees and fiduciaries.

A key focus is on data and evidence; this is seen as the top challenge for IFCs globally, as well as a need for standardisation and consistency of data to enable genuine measurement and evaluation of collective progress.

Skills and talent are also critical, with only 21% of financial centres offering any type of sustainable finance educational activity according to FC4S data. A joined-up approach to address the skills gaps will be a pivotal feature in the years ahead.

## A Common Law Overview

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Under English law, trustees' investment powers are rooted largely in a combination of statute and case law. The Trustee Act 2000 provides a wide power of investment to make any kind of investment that the trustees would make if they were entitled to the assets of the trust. Further, there are obligations for trustees to take the same amount of care as an ordinary prudent person would take if they were managing their own affairs.

This is clearly far reaching and broad. For nearly 40 years, a 'go to' reference point for determining whether trustees are satisfying their duty of care has been the case of *Cowan v Scargill*<sup>2</sup>, which prescribes that "where the purpose of the trust is to provide financial benefit, the power [to invest] must be exercised so as to yield the best financial return for the beneficiaries"<sup>3</sup>.

This clearly raises questions around integrating sustainable practices into an investment portfolio, particularly where doing so might impact on achieving the best possible financial returns for beneficiaries.

What has been seen in recent years, though, is how ESG factors have become more integral to material impact and financial performance, and not necessarily working to the detriment of financial performance. What is often harder to balance is the tradeoff between impact investing and financial performance.

The trajectory is for ESG to be seen not as a problem but as an opportunity, for ESG to be integrated rather than treated separately and distinctly, and for consensus to be achieved amongst beneficiaries. For trustees, in practice this means introducing clear references to ESG and, where necessary, impact investing, in the family charter or equivalent document.

***"The primary risk for trustees in making sustainable investments is around breaching their overarching fiduciary duties to act in the best interests of beneficiaries."*** - Matthew Braithwaite, Partner, Wedlake Bell

Thanks to significant liquidity events over recent years, a growing number of families are now in a position – often for the first time – to consider the direction and application of their wealth, prompting renewed considerations around legacy and long-term planning. ESG has become an organic part of those conversations.

With the NextGen becoming more influential in future planning, it is also becoming more important for advisers to be conscious of the key drivers for the NextGen. Typically, the NextGen are placing the advisory community under increased scrutiny, being more demanding in terms of transparency, wanting quick access to information and demonstrating mounting concern around greenwashing.

For these reasons, advisers need to be conscious of the need to demonstrate robust ESG credentials and consequently upskilling is likely to be a core element of the fiduciary landscape over the coming years.

As far as structuring is concerned, an ESG approach brings with it a need for further considerations for advisers and trustees in new areas such as the tax treatment of ESG assets, whether or not ESG and non-ESG assets should be segregated, a family's risk profile, and the potential for family conflict. Documentation and clear evidence of these sorts of considerations is crucial in demonstrating that a prudent approach has been taken.

With the changing aspirations of families and the world evolving rapidly, there are strong arguments for retaining an element of flexibility within structuring and caution should be exercised when it comes to 'hardwiring' ESG investing into trust constitution documents, investment policy statements or letters of wishes.

Ultimately, ESG has become a core element of the risk management framework for trustees – and the risk involved in not participating in ESG investing is now seen as being as significant as to be participating. The key lies in making sure the trustee has done all it can to weigh up the considerations, look at the permutations, obtain advice and provide evidence, and make a judgement based on those deliberations. Then trustees can proceed with confidence.

***"The pandemic has highlighted systemic risks for all of us in how we live our lives, and clients are seeing the impact of that on those who are less fortunate in society, causing them to refocus their aims and priorities when it comes to investments."***

- Ravi Francis, Partner, Gateley Legal

## A Global Phenomenon

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***"For family offices and private clients, impact minded investors are increasingly asking if their investee company can demonstrate some form of impact framework or accreditation to reflect their mission, such as being or becoming a B Corp. We're even seeing some NextGens setting up their own B Corps, or evolving their existing businesses into B Corps."*** - Tze-Wei Ng, Associate, Stephenson Harwood LLP

The trend towards a greater focus on ESG within private client strategies is a clear international phenomenon and advisers need to be conscious of the nuanced interpretations of ESG and the potential misunderstandings and differing knowledge levels in different markets – particularly when it comes to the differences between ESG integration, impact investing, social enterprise and philanthropy.

Within Asia, for instance, thinking long-term is built into families' DNA and thinking about social impact has long been a part of private client planning. However, whilst in the past, action has been more passive and largely restricted to their philanthropic endeavours, today it is increasingly active and strategic, cutting across philanthropy and investment and even their business arms, as subsequent generations come into play.

In Asia, family values are also vitally important and that plays into ESG thinking. The term 'prosper' is an important term in Asian family wealth planning and refers not to financial returns necessarily but to family values and generations aligning with those values.

***"In that context, there is scope to combine ESG objectives with the letter of wishes, family constitution or deed documents when establishing trusts for Asian clients, to bring together family members and set out clearly what ESG means for the family. Doing so can provide greater certainty, clarity and an extra layer of protection for the trustee."*** - Suzanne Johnston, Partner, Stephenson Harwood LLP

At the same time it is noted that some existing tax exempt charitable structures may have limits on the types of investment and business activities that can be taken up by a more ambitious impact-minded family trust. However, this regulatory space is also evolving as the ESG / impact investing discussion develops as a global phenomenon.

<sup>2</sup> *Cowan v Scargill* [1985] Ch 270

<sup>3</sup> *Megarry V-C*



## The Jersey Legal Perspective

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*“In a traditional sense, acting in the beneficiary’s interests has meant acting in their financial interests. However, the evidence does point to ESG factors being financially material and increasingly a core part of prudent investing.”* - Elizabeth Shaw, Senior Associate, Bedell Cristin

There are similarities between how Jersey and UK law addresses ESG issues, but some differences too. One distinction between Jersey and UK law, for example, is around pension trustees, which have their own regulatory framework in the UK. Significantly, there is currently not a pensions regulator in Jersey – although that is subject to ongoing discussions.

However, generally, trustee duties have evolved in Jersey in a similar way to the UK and similar questions around the relationship between fiduciary duties and ESG are now being asked, going almost full circle to the extent that not taking ESG into consideration could be interpreted as being a breach of duty.

The section of the original Jersey Trust Law that deals with trustee duties talks about trustees exercising their discretions and powers ‘as would a prudent person’.

In addition, the clause citing that trustees should ‘as far as is reasonable’ preserve and enhance the value of trust assets was previously the clause that concerned trustees most. However, evolving attitudes towards ESG and the concept of what is ‘reasonable’ have meant that the flexibility inferred in that clause could actually be an advantage for Jersey – whether it is reasonable to focus on only financial returns at the expense of other negative social or environmental issues provides the basis for an interesting debate.

Although there is still some caution around sacrificing financial benefit to gain societal or environmental benefit, there are a number of Jersey case law sources of reference that provide some useful guidance and an element of comfort to trustees.

In *The May Trust* (2021)<sup>4</sup>, for example, the Court provided a momentous decision that allowed for a wide definition of ‘benefit’ to be adopted, highlighting that ‘wider than financial benefit’ could be interpreted as investment bringing about ‘social or educational benefits’.

Overall, Jersey’s trust law provides an attractive and flexible framework for ESG structuring. Duties and guidance are built into it but with retained flexibility to enable the Courts to continue making momentous decisions that can give trustees confidence in line with societal movements, trends and public policy.

This flexibility can be a significant benefit for trustees, but it does require clear, accurate communication between trustees and clients, and high-quality documentation to be maintained in order for the bespoke terms and objectives of a trust to be maintained, understood and beyond doubt.

It also means that trustees need to be skilled in reconciling the competing or differing interests of beneficiaries, particularly where societal and environmental issues, such as climate change, play out over a long timeframe.

If trustees do not adopt this approach, the nature of Jersey’s multigenerational trusts means that there is clear potential for future litigation, where beneficiaries do not agree.

<sup>4</sup>In the matter of the *May Trust* [2021] JRC 137

*When investing, capital deployment without sustainable risk assessment is a litigation risk. Such risk is exacerbated in the context of the long-term investment horizons which you might typically find in a Jersey multigenerational trust structure. In this sense, Jersey trusts will find themselves in the eye of the storm when it comes to the transition to net zero. In addition, when you look at litigious cases around the world, the nature of the claims underpinning such cases are becoming broader. That means the duty of care that is expected of fiduciaries is becoming broader too.* - Henry Wickham, Counsel, Ogier

## Structuring: Practical Tips for Trustees

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- Be clear on beneficiaries’ interests – Jersey case law places an emphasis on the Letters of Wishes, so trustees should focus on that
- Trustees should review their investment powers and the liability that goes along with that
- Actively review structures to ensure they meet objectives – a private trust company and a foundation are popular options for integrating ESG, beyond standard discretionary trusts
- An incremental approach to integrating ESG is advisable
- Be a proactive self-critic as to whether you are acting as a reasonable trustee
- When it comes to investment, have a robust and open dialogue with investment managers to ensure a ‘good fit’
- Periodically review and measure the performance of the portfolio and investment manager against the ESG strategy – understand the metrics
- Be wary of the traps – it’s easy to put a label on an ESG product at a time when definitions and standardised measurements are still not clear cut and greenwashing remains a major issue
- Practice joined-up thinking in creating a holistic investment portfolio and ask if one strand undermines another

## The Trustee and Family Office Perspective

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*There is a renaissance in the thinking of European families. Their ideas have evolved from unilaterally directing responsibility towards their own family members, which in the past saw effective legacy as adherence to a fixed set of standards and expectations. They now embrace a positive future through responsibility towards our planet, community and society – vastly increasing the circle of people to whom they commit. This empowers legacy to be achieved through outreach, purpose and impact to people and our planet more widely.* - Mustafa Hussain, Managing Director, Accuro Fiduciary

The traditional family view of legacy is being challenged. No longer are families behaving solely in accordance with their deep-rooted constitutions that prescribe how family members will behave, or act in order to benefit from family assets and resources.

Instead, families’ perspectives on legacy are now leading to concepts such as love, respect, fun and humility – far more emotive, organic concepts – being included in legal documents such as mission statements.

At the same time, families are considering including break clauses in investment policies, to allow subsequent generations to change course in the future or to wind up a structure if they feel it is no longer relevant or appropriately benchmarked against future societal and family values.

In turn, this awareness of constant shifts and evolution is changing how families measure their success – something that is creating challenges for trustees in terms of evidencing how they are meeting their obligations.

This prompts questions around standards, how ethical benchmarks are set, and how these are subject to change. Families are increasingly aware that there are issues in determining what is fundamentally right and what is not right and that these are not necessarily binary concepts.

The path is not easy – there are always contradictions and choices that a family, trustees and advisers need to consider.



## Investment Management: Considerations for Trustees

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*It's really important to ask the simple questions; to frame the questions right from the outset; to really understand what the expectations are so that as trustees you can make the right investment management appointment.* - David Stearn, CEO, Affinity Private Wealth

- Start with the basics and don't be afraid to ask simple, to the point questions about appetite towards sustainability
- ESG decisions are inherently more emotive and conflict will arise where there are multiple beneficiaries. Find ways to manage conflict by implementing a framework. This could be based on UN SDGs, for instance
- Integrate that guiding framework into an investment policy statement
- Manage expectations early on around reporting vulnerabilities
- Greenwashing remains a real challenge and it's difficult for trustees to navigate. Look for red flags with investment managers – are they members of the UN Global Compact, is their track record credible as a sustainable offering or have they changed the name of an existing product, for example
- Upskilling is a vital and an ongoing necessity for trustees to identify evidence of greenwashing and understand metrics. There is no universal taxonomy, so be as ahead of the game as you can
- Think about what's coming and make informed judgement calls bearing in mind a potential future direction of travel

When it comes to investment manager appointments, as a trustee it might feel easy to be overwhelmed, but this need not be the case. In the vast majority of cases, there might not need to be a change in investment manager, but rather a shift in approach based on robust engagement – investment managers are increasingly running sustainable investment strategies and integrating sustainable portfolios. Ensure open and effective dialogue!

## ESG as a Driver of Value and Change

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*"We use stewardship as a way to talk to companies we own, and we do that by asking three questions – do you have a net zero goal, do you have a quantitative mid-term target and do you have a business model that is profitable at net zero? These are fiduciary questions to ask and companies are responsive to them. It's also an opportunity for us to make a difference in the real economy, through our own stewardship"* - Dr Chris Kaminker, Head of Sustainable Investment Research and Strategy, Lombard Odier

The increasing expectation from regulators, policy makers and society that investments should result in real world positive outcomes is highlighting the importance of stewardship and investor engagement amongst fiduciaries and investment professionals.

Investment managers are increasingly re-thinking their approach to the global economic model, bringing in concepts such as circularity and planetary boundaries as a means of identifying opportunities and managing risk within portfolios whilst delivering wider sustainable outcomes.

However, although investment performance through the ESG lens can be helpful, it has its limitations. Different ESG metrics and performance evaluation systems can offer different perspectives and caution is necessary in interpreting data.

It's important to understand how ESG data works and exactly what it shows. On its own, it doesn't necessarily measure what a company does, and concluding that a company is 'good' or 'bad' in binary terms is fraught with difficulties.

This reinforces the need to focus on good stewardship and engagement, which is all about being an active owner – incorporating ESG issues into ownership policies and practices in order to drive responsible allocation of capital in a way that delivers long-term value clients as well as sustainable benefits for the economy, the environment and society.

*There's a growing body of academic literature that suggests that to not effectively use engagement and other stewardship tools to manage risk and financial returns may be misaligned with a trustee's duties to clients and beneficiaries.*

- Sophie Lawrence, Greenbank Stewardship and Engagement Lead, Rathbone Greenbank Investments

## The Future of ESG Reporting: Data Literacy is Key

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*We've seen a tsunami of regulation come through which is forcing companies to report mandatorily. The UK is asking companies to report on their climate impact with the US likely to follow, whilst the EU looks set to take its ESRS standards and apply them to all listed companies in the EU. The result is that, in a very short space of time, there is going to be a flood of information. What is then done with all that information and data is key.* - Harry Briggs, Director, Sustainability, KPMG

The current ESG reporting landscape is hugely fragmented. Over recent years, a number of private institutions have sought to develop their own standards to be able to demonstrate ESG credentials in some way – the result has been a myriad of different frameworks, creating a highly complex picture.

That has led to the financial services community collaborating to find a consistent and shared way forward and in turn this has given birth to the idea of convergence in data, metrics, disclosure and reporting standards. The IFRS, overseen by IOSCO, emerged as the most ideal body to lead on this area.

This then paved the way for the creation of the International Sustainability Standards Board (ISSB), announced at COP26 in 2021, with a remit to bring together all private standards into a more coherent framework, initially covering environmental metrics but with the intention to broaden into societal in due course too.

However, divergence still exists, with the EU separately deciding to go even further into sustainability metrics, with an aim to force companies to look at their supply chains in a much more granular way through its 'European Sustainability Reporting Standards' (ESRS). Consulting shortly, the objectives are to bring out a set of standards later in 2022, that will go deeper and be rolled out quicker than those being developed by the ISSB.



Meanwhile, the US is also looking closely at these international standards. Overall, the most likely outcome will not necessarily be convergence, but alignment. Fundamentally, the common thread is that reported ESG data is seen through the lens of risk and opportunities related to sustainability. Investment analysis will take all of this into account and it's therefore important for trustees and firms to carefully consider these risks alongside the opportunities and consider how they are presented to market to satisfy investment managers and their due diligence requirements.

The periodic reporting of data provides perhaps the biggest challenge for trustees, with huge quantities of aggregated data set to be received frequently, requiring careful analysis and scrutiny. Trustees will need to be ESG data literate and decide, when faced with this sea of data, what is most important and what is most relevant for onward reporting to beneficiaries and settlors.

Critically, if a trustee isn't building responsible investment into a portfolio, then they are simply ignoring a whole set of risks that are available for analysis.

## Conclusion

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What is clear is that the integration of ESG factors into the activities of fiduciaries is not going away – indeed, this is a journey that the private wealth sector as a whole needs to go on over the coming years. The recent Butler-Sloss<sup>5</sup> ruling (handed down after our March seminar) brings some additional clarity on the balancing exercise that trustees need to perform between purely financial performance and other considerations such as climate change – a further demonstration of the need to remain fully abreast of the latest developments when it comes to ESG investing. We hope that this paper has helped to frame the current state of play, both in Jersey and beyond, and will generate further thinking and debate on these crucial topics.

<sup>5</sup> Butler-Sloss & Ors v Charity Commission [2022] EWHC 974 (Ch)

## Acknowledgements

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Disclaimer: The information provided in this paper does not, and not intended to, constitute legal or financial advice; instead, all information, content, and materials are for general information purposed only. No reliance should be placed on the information in this paper, and professional advice must always be sought.

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