TaylorWessing
Private Wealth

ESG investing: using private wealth for positive change

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Today's ultra high net worth (UHNW) individuals and their families increasingly want to direct their wealth to positively change the world and many are doing so through ESG investing.

Our recent global study – World Shaping Wealth: The Impact of Affluence on the Next Economy - found that 77% of UHNW individuals are prioritising using their wealth to have a long-term positive impact on society and for charitable aims. UHNW individuals are attracted by ESG investments both because they can ensure their investments align with their values and because ESG funds are increasingly outperforming more traditional funds.

Types of ESG investing

ESG (environmental, social and governance) investing can take a number of different forms. The main types are:

- ESG compliant investing

  Investing in companies that have met or exceed certain ESG criteria – financial returns often remain a primary focus for ESG compliant investing.

- Socially or ethically responsible investing or 'exclusion' investing

  Investments in companies involved in activities that do not correspond with the moral or ethical values of the investor are avoided or eliminated – such as weapons manufacturers, tobacco companies and companies that promote gambling.

  Alternatively, or in conjunction with 'exclusion' investing, investments are actively made in companies that are considered to be socially responsible due to the nature of the companies' business – such as companies that are engaged in social justice, environmental sustainability, or alternative/clean energy.

- Impact investing

  Investing in entities or projects with the aim of achieving certain social or environmental goals. Investors may be actively involved in monitoring the impact their investment is having.

  Impact investing is sometimes considered an extension of philanthropy as the financial returns are often below market, however, investors will generally expect to generate some profit.

Shaping positive change

UHNW individuals have historically made substantial charitable gifts during their lifetime or on death, or established charitable foundations to provide for charitable causes for the long-term. Many UHNW individuals are now considering how they can make broader, more lasting change for society as a whole, partly through ESG investing. It has been suggested that millennials could place between USD15 trillion and USD20 trillion into ESG investments in the next 20 to 30 years.

UHNW individuals investing their own funds into ESG can prioritise social, ethical or environmental considerations over financial returns as they wish without being accountable to anyone else. However, a substantial portion of an UHNW individual's wealth may be held in various asset holding structures, often trusts, and trustees do not have the same freedom when investing.

In a recent case – Butler-Sloss & others v Charity Commission of England and Wales (2022) - the trustees of two charitable trusts were permitted to adopt an investment policy that excluded many profitable potential investments which they considered conflicted with the charitable purposes of the trusts. Justifying an ESG-focused investment policy is more difficult for the trustees of a private family trust.

> *For the millennial generation of UHNW individuals, ESG factors play a large role in their investment decisions. They are not simply following current trends, it is important to them that they invest in a way that leaves a positive mark on society.*
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> **Martin Kraus , Partner, Germany**

Trusts and ESG: challenges for trustees

Trustees' duties

Trustees have a duty to preserve trust property and act in the best interests of the beneficiaries and so must, generally, invest for maximum financial return. This is the case even where the trustees are given, by the trust instrument or the governing law of the trust, the same powers of investment as a natural person acting on their own account.

Beneficiaries' views

Beneficiaries' views on ESG investments may differ across generations. Recent studies have put the figure of young UHNWs drawn to ESG investments as high as 50%, whereas for over 60s the figure is around 15%. Balancing the views of different beneficiaries can place trustees in a difficult position. While trustees may agree to avoid certain investments that one or more beneficiaries object to on moral, ethical or religious grounds they should not pursue an investment policy simply to accommodate the views of beneficiaries. Trustees must act in the best interests of all the beneficiaries taking into account the interests of minor and unborn beneficiaries.

Liability for investment losses

Trustees may have wide powers of investment under the trust which would not preclude them from investing in ESG investments, however, if these investments fail to perform as well as more traditional funds the trustees may be vulnerable to claims from disgruntled beneficiaries who do not consider that ESG considerations should have been taken into account in the investment policy.

Potential solutions

Express power to invest in ESG

Specific provisions can be included in a trust instrument giving the trustees power to invest in ESG investments of a particular description and providing that the trustees will not be liable for any loss arising as a result of making such investments. The trustees would still have a duty to review the investment policy regularly and consider whether they should diversify or vary investments.

Reserved investment powers

Alternatively, the trust can give the settlor, or another beneficiary, power to direct the trustees to make investments. To protect the trustees it would also be necessary to provide that they will not be liable for any loss arising as a result of following any such direction. The trustees would still have a duty to monitor the performance of the directed investments and consider whether they should be retained (unless, for example, the trust instrument prohibited the trustees from selling or otherwise dealing with any directed investments). It would be important to consider whether including such provisions in the trust has any adverse tax, or non-tax, implications.

Purpose trusts

In a number of jurisdictions it is possible to establish a non-charitable purpose trust. Such a trust could be established for the purpose of ESG investing (or for more specific ESG aims). Most purpose trusts do not have any beneficiaries, however, in certain jurisdictions, it is possible to have a 'hybrid' trust where one of the aims is to administer the trust in the interests of any specified beneficiaries. UHNW individuals who wish to allocate a portion of their wealth to ESG investing, in particular impact investing, may be happy to accept that those funds will not be available to their family, considering it as part of their wider philanthropic giving. Introducing beneficiaries into a purpose trust will bring with it the requirement for the trustees to consider the interests of those beneficiaries and is likely to restrict the ESG investments which can be considered.

Foundations

Using a foundation for ESG investments will alleviate some of the concerns highlighted above in relation to trusts.

The members of a foundation council have a duty to ensure that the objects of the foundation are achieved. These objects often include benefitting a particular group of persons (the beneficiaries) but can be drafted to include other non-charitable purposes, including to allow for ESG investing.

Planning for positive change

There is no doubt that for many UHNW individuals ESG investing will form part of their overall wealth management strategy in the future. How UHNW individuals invest in ESG and use their wealth to make a positive change in the world will continue to evolve. Some UHNW individuals will see ESG investing as an extension of their philanthropic giving and be happy to dedicate a portion of their wealth to those aims, without being concerned about the financial returns.

Trustees being asked to consider ESG investments should review their powers and protections and ensure they reach out to beneficiaries to understand their views.