THE CONSIDERATION OF NON-FINANCIAL MATTERS IN THE EXERCISE OF TRUSTEES' POWERS OF INVESTMENT

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1. The purpose of this note, produced on the instructions of Bates Wells, acting for Good Ancestor Limited, is to explore the extent to which it can be appropriate or necessary for trustees of private trusts to take account of non-financial matters when considering an exercise of their powers of investment.

2. In particular, I am asked to consider the exercise of trustees' general power of investment with regard to anything other than the best financial return for the trust, and, in particular, the potential pursuit of investment strategies that align with personal views of beneficiaries and settlors in respect of (i) the impact of investments on the environment and wider society, and (ii) appropriate approaches to the governance of entities in which trustees might invest. This arises at a time of greater awareness of, and enthusiasm for, such investment strategies (often termed sustainable, impact-based, or ethical investment strategies) among many trustees, settlors and beneficiaries.

3. In summary, **this note proposes that, in suitable circumstances, there is greater scope for trustees to take account of non-financial considerations when exercising their powers of investment, and, in particular, to pursue investment strategies that align with personal views of beneficiaries and settlors in respect of (i) the impact of investments on the environment and wider society, and (ii) appropriate approaches to the governance of entities in which trustees might invest than might commonly be considered at present**.

4. I understand that this opinion may be shared with third parties to assist with consideration of this issue. To assist those reading it, I record that I was called to the Bar of England and Wales in July 2006, and was appointed Queen's Counsel (now King's Counsel) in February 2018. I practise from XXIV Old Buildings, the chambers of Elspeth Talbot Rice KC, in Lincoln's Inn, London, and specialise in the law of trusts. I appeared in various cases cited below, including *Lehtimäki v Children's Investment Fund Foundation (UK)* [2018] EWCA (Civ) 1605, [2018] WTLR 491, *Lehtimäki v Children's Investment Fund Foundation (UK)* [2020] UKSC 33, [2022] AC 155, and *Butler-Sloss v Charity Commission for England and Wales* [2022] Ch 371.

Trustees' powers of investment

5. Trustees' obligations in respect of investing the assets of a trust depend on the nature and scope of the powers of investment that they have as trustees. This is, accordingly, where any analysis should begin.

6. Under the law of England and Wales, the starting point is the powers of investment that are conferred by statute, subject to any enlargement or restriction of that statutory power that might be set out in the governing instrument(s) of the trust in question.

7. Section 3 of the Trustee Act 2000 introduced a wide general power of investment. Section 3(1) states that:

> "*(1) Subject to the provisions of this Part, a trustee may make any kind of investment that he could make if he were absolutely entitled to the assets of the trust….*"

8. This power is defined by section 3(2) of the Trustee Act 2000 as "*the general power of investment*". It is a very wide power indeed, although "*investment*" does not include an asset from which no profit or income is expected,[1] and, for completeness, section 3(3) goes on to make clear that this general power of investment does not permit a trustee to make investments in land other than in loans secured on land.

9. Section 6(1)(b) of the Trustee Act 2000 makes clear that this general power of investment is "*subject to any restriction or exclusion imposed by the trust instrument or by any enactment or any provision of subordinate legislation*".[2]

10. This is an important provision. It means that, when settling a trust today, it is open to a settlor to craft the powers of a trustee in a way that best accords with the settlor's wishes – and to confer on a trustee powers of investment that would allow the trustee to pursue investment strategies that align with personal views of the settlor and beneficiaries in respect of (i) the impact of investments on the environment and wider society, and (ii) appropriate approaches to the governance of entities in which the trustee might invest. In the light of the matters addressed below in this note, both prospective settlors, and those advising prospective settlors, may wish to give particular consideration to these matters.

11. For present purposes, however, I consider the position on the premise that the relevant trust instruments governing trusts that might be considering the contents of this note contain no

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[1] See *Lewin on Trusts*, §35-002 and §35-018.

[2] Insofar as trusts were settled before 1961, section 7 of the Trustee Act 2000 states:
"*(1) This Part applies in relation to trusts whether created before or after its commencement.*
(2) No provision relating to the powers of a trustee contained in a trust instrument made before 3rd August, 1961 is to be treated (for the purposes of section 6(1)(b)) as restricting or excluding the general power of investment.
(3) A provision contained in a trust instrument made before the commencement of this Part which –
(a) has effect under section 3(2) of the Trustee Investments Act 1961 as a power to invest under that Act, or
(b) confers a power to invest under that Act,
is to be treated as conferring the general power of investment on a trustee."

relevant restrictions. The trustees of any trusts considering the exercise of their power of investment would, however, of course, have to identify, and consider carefully, whether this is the case.

12. For the avoidance of doubt, these statutory investment powers do not just apply to allow a trustee to invest cash in an appropriate authorised investment. In *Hawksford Trustees Jersey Ltd v Stella Global UK Ltd* [2011] EWHC 503 (Ch) (affirmed by the Court of Appeal in [2012] EWCA Civ 55, [2012] 2 All ER (Comm) 748), the English High Court found that a power to invest is also a power to sell investments, and, absent specific provision in the relevant trust instrument, trustees are generally under an ongoing duty to give appropriate consideration to whether to exercise a power to sell investments.

The proper approach to trustees' exercise of their powers of investment

13. Where trustees have a power of investment then, generally speaking under English law, trustees are under a duty to make the trust fund productive for their beneficiaries by investing it in accordance with that power: see, for example, Lindley LJ in *Re Whiteley; Learoyd v Whiteley* (1886) 33 ChD 347, at 355, and Lewin on Trusts at §35-001.[3]

14. The scope and content of this duty is, to a great degree, codified in detail in the Trustee Act 2000.

15. Under the Trustee Act 2000, it is not enough for trustees simply to invest their trust funds within the classes of investment authorised by the statutory power of investment or the trust instrument.

16. In exercising their powers of investment, and their duty to review investments under the Trustee Act 2000, trustees must exercise appropriate skill and care, in accordance with the statutory duty of care laid down by section 1 of the Trustee Act 2000. In exercising this duty:

    16.1. They must first, usually, seek proper advice about the way in which, having regard to the suitability of the proposed investments, the powers should be exercised (as required expressly by section 5 of the Trustee Act 2000).

[3] In this respect, to make a trust fund productive might be understood to mean to take steps to have it generate a return (rather than, for example, and by way of distinction simply holding the fund in cash such that it would stand to be eroded by inflation). Precisely how the trust fund should be made productive, and the steps that a trustee should take, is addressed further in this section of the note.

16.2. After obtaining and considering such advice, trustees must:

16.2.1. act with a single eye to the benefit of their beneficiaries (as to which, in particular, see further below);

16.2.2. exclude all ulterior purposes;

16.2.3. exercise the statutory duty of care in the selection of investments from among those that are authorised by the relevant power of investment;

16.2.4. have regard to the suitability of the investments;

16.2.5. have regard to the need for diversification;

16.2.6. obtain all necessary consents to the investments;

16.2.7. act fairly and impartially as between beneficiaries with different interests, particularly those interested in income and capital; and

16.2.8. review the investments on the same basis at suitable intervals after they are made.

17. In particular, section 4(1) of the Trustee Act 2000 requires trustees, when exercising their powers of investment, to have regard to the standard investment criteria, which are stipulated to be:

17.1. "*the suitability* ***to the trust*** *of investments of the same kind as any particular investment proposed to be made or retained and of that particular investment as an investment of that kind*"; and

17.2. "*the need for diversification of investments of the trust,* ***in so far as is appropriate to the circumstances of the trust***".

18. Each of these criteria can accordingly be said – consistent with the words emphasised – to contemplate that regard will be had to particular features of the trust. Support for the suggestion that this encompasses non-financial matters can also be found in section 5 of the

Trustee Act 2000 which requires trustees to obtain and consider "*proper advice*" before exercising any power of investment. Sectio 5 defines proper advice as being that of a person who is "*reasonably believed by the trustee to be qualified to give it by his ability in and practical experience of financial* ***and other matters*** *relating to the proposed investment*" (emphasis added).

The standard by which the trustees' exercise of their duties will be assessed

19. In *Re Whiteley; Learoyd v Whiteley* (1886) 33 ChD 347 Lindley LJ said, at 355, that:

> "*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 business man would take if he was minded to make an investment for the benefit of other people for whom he felt morally bound to provide*."

20. In acting "*as a prudent investor*", and exercising "*reasonable care, skill and caution*", a higher standard is likely to be required of a person holding himself or herself out as a professional trustee. Thus, in *Bartlett v Barclays Bank Trust Co Ltd* [1980] Ch 515. Brightman J said:

> "*I am of opinion (sic.) that a higher duty of care is plainly due from someone like a trust corporation which carries on a specialised business of trust management...a professional corporate trustee is liable for breach of trust if loss is caused to the trust fund because it neglects to exercise the special care and skill which it professes to have*."

21. Moreover, the duty to act as "*as a prudent investor*" and to exercise "*reasonable skill, care and caution*" will include a "*duty to seek advice on matters which the trustee does not understand, such as the making of investments, and on receiving that advice to act with the same degree of prudence*": see *Cowan v Scargill* [1985] Ch 270.

22. A trustee should not choose an authorised investment if it is speculative or a gamble, as many of those within the statutory general power of investment will be. The burden of proving, however, that it was nonetheless too hazardous to be accepted as a trust investment lies on the beneficiaries who complain about it: see *Shaw v Cates* [1909] 1 Ch 389 at 395.

23. As matters stand, beneficiaries that wish to make trustees accountable for loss (or perceived loss) from an investment will carry a heavy burden. The exercise of a trustee's power is not open to challenge simply on the ground that the court disagrees with it or the court would have exercised the power differently: see *Re Londonderry's Settlement* [1965] Ch 918 at 936; *Edge v Pensions Ombudsman* [1999] Ch 512 at 534 and 536; and paragraph 50 of *Lehtimäki v Children's Investment Fund Foundation (UK)* [2018] EWCA (Civ) 1605, [2018] WTLR 491

(overturned by the Supreme Court in *Lehtimäki v Children's Investment Fund Foundation (UK)* [2020] UKSC 33, [2022] AC 155, but not in terms that affect this proposition). Beneficiaries that wish to make trustees accountable for loss (or perceived loss) from an investment will have to satisfy the court that, at the time that the investment was made, a prudent or reasonably careful person would not have chosen it, assuming that the trustees have otherwise followed the process contemplated by the Trustee Act 2000.

The scope for trustees to consider non-financial matters in the exercise of investment powers

24. When considering trustees' powers of investment, and their related duties, it is important to bear in mind that – subject to particular obligations imposed in respect of the exercise of the power of investment by statute or a trust instrument – trustees' powers of investment, and to vary investments, are discretionary powers.

25. Thus, trustees have the discretion as to whether and, if so, how to exercise it (within the constraints of the relevant power, and subject, as appropriate, to the consent of a protector or some other person). They may not enter into any form of commitment as to how the power may be exercised in the future (save where expressly permitted to do so by a relevant trust instrument). They may, however, adopt a policy in respect of the potential exercise of a power, to the extent that they do not, by so doing, bind themselves.[4] If adopting a policy, they should also keep in mind that it cannot excuse them from their obligation to review investments, and to consider whether to follow the policy, at appropriate intervals.

26. Nevertheless, as is clear from the above, and as is the case in respect of powers other than powers to make and vary investments, trustees do not have a completely free hand. In the exercise of any discretionary power, they must act responsibly and rationally, taking into account relevant matters, and not irrelevant matters. In this latter respect, there is no fixed list of legally relevant matters – the point is often one of common sense.

27. In considering the exercise of powers to invest and vary investments in the circumstances of any particular trust, in addition to the other express requirements of the Trustee Act 2000, trustees are also likely to be able to accord due weight to other factors including:

[4] See *Lewin on Trusts*, 19th ed., §29-228, although note that trustees' actions may entitle a beneficiary to raise an estoppel against them (see, in this regard, *Fielden v Christie-Miller* [2015] WTLR 1165).

27.1. the wishes of the settlor (which are relevant because the person who has substantially supplied the assets of the trust is the source of the bounty that comprises those assets – although such wishes are not binding and may be viewed as being due diminishing weight as time passes); and

27.2. the wishes of the beneficiaries.

28. With this in mind, *Lewin on Trusts* suggests, at §35-073, that where the trust fund comprises shares in a family company, and the settlor has expressed a wish to keep the shares in the family for the benefit of the beneficiaries, it is likely to be for the benefit of the beneficiaries to do so – and that it may be hard to fault trustees for taking into account quite a wide field of family, business and similar circumstances in deciding whether, and, if so, to what extent, to diversify the trust fund.

29. It is hard to see why this approach should not also extend to allow trustees to exercise their general power of investment with regard to matters other than pure financial return for the trust, including, in particular, the value to the beneficiaries of pursuing investment strategies that align with personal views of beneficiaries and settlors in respect of (i) the impact of investments on the environment and wider society, and (ii) appropriate approaches to the governance of entities in which trustees might invest.

30. Such an approach would be consistent with a wider view of what is meant by "*benefit*" of beneficiaries, of the kind that can be gleaned from a decision of the Royal Court of Jersey in *In the matter of the May Trust* [2021] JRC 137 [2022] WTLR 637. The case arose from an application by the Jersey Trustee of the May Trust, who sought the court's approval and/or sanction for a proposed distribution of a significant portion of the trust fund to a beneficiary, intended for onward transmission to a charitable foundation—itself also a beneficiary of the trust. The central question was whether this distribution constituted a "*benefit*" to the individual beneficiary and whether the trustee's decision aligned with the trust's purpose. The court proceeded on the basis that "*benefit*" in trust law extends well beyond mere financial gain and should not be narrowly interpreted. Drawing on a range of Jersey and English law precedents, the court articulated a broad interpretation of "*benefit*" incorporating, in particular:

30.1. educational and social benefits, including advantages such as promoting family harmony or providing educational opportunities, which enhance the beneficiary's well-being beyond monetary terms;

30.2. tax-related benefits, including practical financial relief, such as the payment of debts owed to HM Revenue & Customs (HMRC), or preventing a beneficiary's parents from incurring significant tax liabilities due to transfers into the trust; and

30.3. discharging a moral obligation, most likely in the form of charitable giving (the obligation being one the beneficiary has recognised needs discharging).

31. The court emphasized that this wide interpretation allows trustees flexibility to act in the best interests of beneficiaries, provided their decisions remain rational and aligned with the trust's framework.[5]

32. Drawing an analogy with the approach adopted by Michael Green J in *Butler-Sloss*, it might therefore be said that where trustees are of the reasonable view that particular investments or classes of investments potentially conflict with the interests or wishes of their beneficiaries, the trustees have a discretion as to whether to exclude such investments and they should exercise that discretion by reasonably balancing all relevant factors including, in particular, the likelihood and seriousness of such a potential conflict and the likelihood and seriousness of any potential financial effect from the exclusion of such investments. By continued analogy, if they conduct such a balancing exercise properly, and a reasonable and proportionate investment policy is thereby adopted, the trustees have complied with their legal duties in such respect and cannot be criticised, even if the court or other trustees might have come to a different conclusion. This ought to give trustees substantial comfort.[6]

33. For the avoidance of doubt, this approach does not invite a situation – perhaps analogous to those contemplated in *Cowan v Scargill*, *Harries v Church Commissions for England* [1992] 1 WLR 1241, and *Butler-Sloss v Charity Commission for England and Wales* [2022] Ch 371 – where trustees might pursue investments on the basis of *the trustees' own* personal morality or ethics, to the financial or other detriment of beneficiaries, as a consequence of their focus

[5] In various respects this echoed the Supreme Court decision in *R (Palestinian Solidarity Campaign Ltd and anor) v Secretary of State for Housing, Communities and Local Government* [2020] 1 WLR 1774, where both Lord Wilson and Lord Carnwath JJSC expressly approved a statement in the Law Commission's report entitled *Fiduciary Duties of Investment Intermediaries* (2014) (Law Com No 350) as to when pension trustees can take into account non-financial factors in relation to investment decisions. Lord Carnwath said that pension trustees may take non-financial considerations into account "*provided that doing so would not involve significant risk of financial detriment to the scheme and where they have good reason to think that scheme members would support their decision*." The use of the language of "*significant risk of financial detriment*" – drawing on the language of "*risk of significant financial detriment*" in earlier first instance cases discussed elsewhere – may have to be revisited in the light of the reconsideration of those cases in *Butler-Sloss*.

[6] Over and above such comfort as they may already have from the kinds of exoneration clause that appear so frequently in modern trust instruments.

on the wishes of the beneficiaries and settlors. Trustees will still be obliged not to pursue their personal interests.

34. Similarly, it does not place unjustified – or unwelcome – burdens on trustees to consult beneficiaries. Insofar as the trustees' decision-making might involve an assessment of facts, and thereby incorporate a duty to inquire, and to ascertain, in doing so it is not necessary that they "*must worry their heads to survey the world from China to Peru*": see Harman J in *Re Gestetner Settlement* [1963] Ch 672 at 688-689. Further, trustees are not held to a standard of perfection in the investigations that they are obliged to carry out in forming judgments: see *Pitt v Holt* at paragraphs 68 and 73.[7]

35. Nor would this approach undermine the compelling *dicta* as to the importance of trustees having regard to modern portfolio theory in considering making investments.[8] It is true that both (a) a choice by a trustee to adopt a 'negative screen' – by excluding certain investments that do not accord with, for example, particular views on (i) the impact of investments on the environment and wider society, and (ii) appropriate approaches to the governance of entities in which trustees might invest – and (b) a choice by a trustee to adopt a 'positive screen' – by actively pursuing investments with a particular profile that is thought to be attractive from the perspective of environmental, social or governance considerations – may be said to conflict with portfolio theory. This is because, with more focussed investments, the market generally demands a higher return, of income and/or capital appreciation, for a higher risk. By holding a diversified portfolio, an investor reduces the overall level of risk without reducing the total returns from the individual investments. Any choice made in relation to a potential portfolio may have such an effect though, and choices are routinely made by all investors. So long as a trustee has due regard to the importance of investment portfolio theory when exercising their discretion, and also weighing other appropriate factors, this ought not to be a barrier to consideration of other appropriate factors in suitable circumstances.

36. The approach would also be reconcilable with the series of English cases, beginning with *Cowan v Scargill* [1985] Ch 270, that led to questions being raised as to the ability of trustees of private trusts to exercise their general power of investment to pursue anything other than

[7] Albeit that none of this should act as a disincentive for beneficiaries to share their views and preferences with their trustee.

[8] These include, in particular, Hoffmann J's observation, in *Nestlé v National Westminster Bank Plc* (1988) [2000] WTLR 795 at 802, that trustees "*acting within their investment powers are entitled to be judged by the standards of current portfolio theory, which emphasises the risk level of the entire portfolio rather than the risk attaching to each investment taken in isolation*".

the best financial return for the trust. Sir Robert Megarry VC observed in *Cowan v Scargill*:

36.1. at 289A, that "*Under a trust for the provision of **financial benefits**, the paramount duty of the trustees is to provide the greatest financial benefits for the present and future beneficiaries*";

36.2. at 287F to 287G, that where two investments are equally suitable, a trustee can choose between them on social or political grounds, but the trustee's decision will normally be open to criticism if the investment in fact made is less beneficial; and

36.3. at 288E to 288H, that, where all the actual or potential beneficiaries of a trust were adults with "*very strict views on moral and social matters, condemning all forms of alcohol, tobacco and popular entertainment, as well as armaments*", it might be for their benefit for the trustees to consider the views of the beneficiaries – but that he considered that such cases were likely to be very rare.

37. Three points bear making here:

37.1. First, *Cowan v Scargill* concerned a pension trust – which is, *par excellence*, a trust for the provision of financial benefits in which other considerations might be said be of particularly limited significance. Perhaps crucially, the case succeeded in Cowan v Scargill because, as Sir Robert said at 296B to 296C, he could not see how the adoption of the restrictions would, inter alia, "*bring any appreciable benefit to the beneficiaries under the scheme*". This would not, of course, be the case for trustees pursuing a wider concept of "*benefit*" flowing from a private trust.

37.2. Second, even in the context of a pension trust, Sir Robert Megarry VC qualified his comments by saying that while the trustees' paramount concern must be the beneficiaries' financial benefit, there may be non-financial benefits that the beneficiaries may wish to obtain even if they might as a result receive lesser financial benefits. Although he thought that this would rarely be the case, that sits ill with a more modern approach, especially given the legislative developments (touched on above) that have taken place since that case.

37.3. Third, Sir Robert described his judgment, in an article written extra-judicially in 1989,[9] as "*a dull case*", which would not have been given any attention but for the previous lack of authority, and expressed the view that his judgment had decided nothing new. He suggested that *Cowan v Scargill* did not support the thesis that profit maximisation alone would be consistent with the duties of a pension fund trustee considering its powers of investment.

38. *Cowan v Scargill* can therefore be read consistently with the approach that envisages trustees to be exercising a judgment as to how to invest to best further the purposes of the trust that takes account of both financial returns, and other potential downsides for the trust or its beneficiaries of making particular investments. Viewed in this way, trustees would still be obliged to take account of standard investment criteria, need for advice and any advice, the prospect of return and risk, but would also have to take account of appropriate non-financial benefits or disbenefits that may result from particular investments. How best to strike the balance would be a matter for trustees' discretion – exercising such skill and care as is reasonable in the circumstances.

39. It is on the basis of analyses consistent with this that the perceived strictness of the approach following *Cowan v Scargill* has been downplayed in certain academic and practitioner texts, and the Law Commission observed, in its report entitled *Fiduciary Duties of Investment Intermediaries* (2014) (Law Com No 350), that it was unhelpful to characterise the purpose of an investment power as being simply to "*maximise*" investment returns: see paragraphs 5.52 – 5.55.[10]

40. Although the lack of legislative or judicial adoption of a more open approach to date has meant that there is lingering uncertainty – see, most recently, Ooi and See, 'Promoting ESG Investing by Trustees: Risk Management and Structuring Solutions; (2024) King's Law Journal, 35:1, 68-88 – this ought not to deter private trustees from the proper execution of their duties in the best interests of their beneficiaries. On the analysis above, the proper execution of those duties does not always require a blinkered focus on maximising financial returns alone.

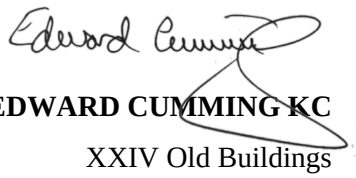
[9] See Megarry R, 'Investing Pension Funds: The Mineworkers Case' in 'Equity, Fiduciaries and Trusts' (Carswell,1989).

[10] The Law Commission contemplated that an alternative characterisation might be the pursuit of the "*best realistic return*" – albeit that it is not immediately clear that this is an improvement or brings desirable requisite clarity, but it does contemplate the more open-textured approach that this note advocates.

Conclusion

41. On the basis of this analysis, it can be seen that, in suitable circumstances (as discussed above), there is greater scope for trustees to take account of non-financial considerations when exercising their powers of investment, and, in particular, to pursue investment strategies that align with personal views of beneficiaries and settlors in respect of (i) the impact of investments on the environment and wider society, and (ii) appropriate approaches to the governance of entities in which trustees might invest than might commonly be considered at present. Trustees may, therefore, be well-advised to give more careful consideration to these matters than may have been the case in the past.

42. I hope that these observations are of assistance and are what was required by our instructing solicitors. If they give rise to any further questions, or if I can be of any further assistance in any other way, including by reconsidering the position in the light of further materials, I would be very happy to do so.



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