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Investing in and for the Future: ESG Investing for Trust Assets Under the Prudent Investor Rule

Jane Gorham Ditelberg*

Individual investors have been increasingly flocking to investment opportunities that involve consideration of the environment, social, and corporate governance records of the companies they invest in.¹ This approach today is generally referred to as ESG Investing, Socially Responsible Investing, or Sustainable Investing.² What started as instructions from investors to avoid companies or assets in their portfolios (e.g. a direction to avoid investing in a specific company responsible for an oil spill) became negative screens (e.g. a direction to avoid investing in all petroleum producers), then became directives to seek out and affirmatively invest in companies with values aligned to those of the investor (e.g. proactively invest in alternative energy technologies).³ Investors are looking at renewable energy but also fair labor policies, responsible board governance, corporate social responsibility, and many other factors.⁴ While at the outset, many believed this would mean a trade-off – receiving a lower rate of return on the investment in exchange for positive social goods,⁵ that has not necessarily been the case. In the end,

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¹ As an example, assets in sustainable funds exceeded \$300 billion in the second quarter of 2021, which nearly doubled the \$159 billion held at the same time in 2020. Alyssa Stankiewicz, *U.S. Sustainable Fund Assets Reach a New Milestone in 2021's Second Quarter*, MORNINGSTAR (July 26, 2021), <https://www.morningstar.com/articles/1048918/us-sustainable-fund-assets-reach-a-new-milestone-in-2021s-second-quarter> [<https://perma.cc/N4BH-KXN3>].

² *What is ESG Investing?*, ADEC INNOVATIONS, <https://www.adec ESG.com/resources/faq/what-is-esg-investing> [<https://perma.cc/PP2E-59HX>].

³ See Peter Gassmann et al., *Are You Ready for the ESG Revolution?*, PWC 3-4 (June 14, 2021) <https://www.pwc.com/us/en/services/esg/library/assets/pwc-sb-2021-06-15-are-you-ready-esg-revolution.pdf>.

⁴ See *id.* at 2-3.

⁵ See Alicia Adamczyk, *Millennials Spurred Growth in Sustainable Investing For Years. Now All Generations Are Interested in ESG Options*, CNBC (May 21, 2021, 9:00 AM), <https://www.cnbc.com/2021/05/21/millennials-spurred-growth-in-esg-investing-now-all-ages-are-on-board.html> [<https://perma.cc/5HX4-CTDD>].

several studies have shown that ESG Investing can result in at least the same rate of return as other approaches to portfolio construction.⁶

It is not surprising then, that wealthy individuals who have followed the path of ESG Investing in their own portfolios are looking to trustees of the trusts that they create or benefit from to take a similar approach. Trustees then face a new question – is there legal authority for a trustee to consider ESG factors in investing trust assets? And there if there is, is there possibly an obligation to consider those factors? A big part of this question has been whether it is the grantor’s values or those of the beneficiaries that should guide the investment decision making.

The primary guidance on trust investing for trustees, beyond the terms of each individual trust agreement, is the Prudent Investor Rule – a statutory rule enacted in nearly every state.⁷ These statutes generally provide a list of factors for a trustee to consider in making trust investments, place the focus on diversification and portfolio construction, and mandate that the suitability of any particular investment is not determined in a vacuum but instead on its role in the overall investment program for the trust.⁸ Does the Prudent Investor Rule permit a trustee to invest trust assets in a program of Sustainable Investing?

Most of the Prudent Investor statutes were enacted prior to the recent trends towards ESG Investing, and do not mention the topic. However, the basic premise of the statutes, laid out for example in section 2(a) of the Uniform Prudent Investor Act, is that a trustee should invest with “reasonable care, skill and caution,” with consideration of the circumstances of the trust, as a prudent investor would. As ESG factors continue to drive investment decisions for non-trustee investors, it is not unreasonable to conclude that this will, now or in the future, be considered a pertinent factor in prudent portfolio construction, applicable to trustees as well as other investors.

Language in the Prudent Investor statutes, such as section 2(c)(8) of the Uniform Prudent Investor Act, directs a trustee to consider “an

⁶ “Increasingly, we see investors embrace ESG investing due to the ‘value’ it offers to long-term investors.” Alison Weiner & Rakhi Kumar, *Five Trends Changing the ESG Investing Landscape in 2019*, IR MAG. (Jan. 25, 2019), <https://www.irmagazine.com/buy-side/five-trends-changing-esg-investing-landscape-2019> [<https://perma.cc/A56K-MGWG>]; see Gunnar Friede et al., *ESG and Financial Performance: Aggregated Evidence from More Than 2000 Empirical Studies*, 5 J. SUSTAINABLE FIN. & INV. 210, 212 (2015).

⁷ Trent S. Kiziah, *Uniform Prudent Investor Act and Modern Portfolio Trust Investment Statutes*, ACTEC ST. SURVEY, https://www.actec.org/assets/1/6/Kiziah_50_State_UPIA.pdf?hssc=1.

⁸ See, e.g., the Uniform Prudent Investor Act, (“UPIA”) now Article 9 of the Uniform Trust Code (“UTC”). The UTC promulgated in 2000 included the UPIA as Article 9. In 2000, at the time the UTC was published, 35 states had already adopted the UPIA. See UNIF. TR. CODE, prefatory note (UNIF. L. COMM’N amended 2010).

asset's special relationship" to the purposes of the trust or to the beneficiaries. This opens the door to considering a role for the values and goals (both monetary and non-monetary) of the grantor and the beneficiaries in making investment decisions. This language has been used to support retaining stock in a family business despite a lack of diversification, and to allow trusts to invest in residential properties for a beneficiary to use, or to carry on a grantor's specific investment philosophy.⁹ It is not hard to imagine circumstances under which a grantor's or beneficiary's strong feelings about ESG Investing would be appropriate considerations for a prudent trustee under this general language.

Five states (Delaware, Georgia, Oregon, New Hampshire, and Illinois) have recently amended their Prudent Investor statutes to address directly ESG Investing.¹⁰ In each case, the new provisions are applicable to both new and existing trusts, and include ESG factors among the considerations for a trustee in investing trust assets. In the case of at least one of the states, this was enacted in conjunction with the state's decision to officially include ESG factors to be considered in investing public monies.¹¹

The Delaware statute provides that, "when considering the needs of the beneficiaries, the fiduciary may take into account . . . the beneficiaries' personal values, including the beneficiaries' desire to engage in sustainable investing strategies that align with the beneficiaries' social, environmental, governance or other values or beliefs of the beneficiaries."¹² The Georgia statute takes a very similar approach.¹³ What is authorized by these statutes, assuming the trust does not contain any

⁹ See, for example, *Bank One Trust Co., N.A. v. Scherer*, No. 11AP-1140, 2012 WL 5555825, at *5 (Ohio Ct. App. Nov. 15, 2012), where the court stated that "if a trustee determines special circumstances exist, such as a family business that has sentimental value, the trustee is not required to diversify." See also *In re Trust Created by Inman*, 693 N.W.2d 514, 520-21 (Neb. 2005), which precluded a trustee from selling a farm with special significance to the beneficiaries; and *Shriners Hospitals for Children v. First Northern Bank of Wyoming*, 373 P.3d 392, 393, 406 (Wyo. 2016).

¹⁰ Delaware amended its statute in 2018, Georgia amended its statute in 2021, Oregon amended its statute in 2019, New Hampshire amended its statute in 2021, effective August 30, 2021, and Illinois amended its statute in 2019, effective January 1, 2020. See DEL. CODE ANN. tit. 12, § 3302(a) (2021); GA. CODE ANN. § 53-12-340(d) (2021); OR. REV. STAT. § 130.755(3)(i)-(j) (2021); N.H. REV. STAT. ANN. § 564-B:9-902(c) (2021); 760 ILL. COMP. STAT. 3/902(c)(7)-(8) (2021).

¹¹ This is consistent with the Illinois legislature's passage in the same legislative session of the Illinois Sustainable Investing Act. 30 ILL. COMP. STAT. 238. This Act specifies similar factors for consideration in the investment of public funds.

¹² DEL. CODE ANN. tit. 12, § 3302(a).

¹³ "In investing and managing trust assets, the trustee may consider the personal values of the beneficiaries, including but not limited to a desire to engage in investing strategies that align with social, political, religious, philosophical, environmental, governance, or other values or beliefs of the beneficiaries." GA. CODE ANN. § 53-12-340(d).

guidance to the contrary, is consideration of the values of the beneficiaries and the beneficiaries' interests in ESG Investing. The trustee, in an exercise of its discretion, will need to discern those values and balance the interests of multiple beneficiaries of a single trust when designing the trust's portfolio.

The Oregon approach allows the trustee to take into consideration in selecting investments the values and objectives of the grantor of the trust as well as those of the beneficiary, to the extent they are known to the trustee.¹⁴ This broadens the scope of the trustee's discretion but also may require balancing differing perspectives and concerns (those of the grantor and those of the beneficiary) who in a long-term trust may live in eras decades or even centuries apart. The Oregon statute does not give priority to the interest of either the grantor or the beneficiaries so the trustee will need to evaluate those interests in its overall exercise of discretion in carrying out the terms of the trust.

New Hampshire takes the Oregon approach one step further, and looks to the values of the "interested persons." The newly amended statute provides that

unless contrary to settlor intent or otherwise prohibited . . . , the expressed wishes of the interested persons of the trust, including where applicable the director of charitable trusts as described in RSA 564-B:1-111(a), as reflected in a nonjudicial settlement agreement pursuant to RSA 564-B:1-111, to have the trustee, trust advisor, or trust protector engage in investing strategies that align with the interested persons' social, environmental, or governance objectives or other values or beliefs of the interested persons, regardless of investment performance.¹⁵

The New Hampshire trustee, like the Oregon trustee, will have an obligation to balance the interests of multiple parties without any guidance on how to do so from the statute. However, the New Hampshire version looks to "expressed wishes", meaning perhaps there is not an obligation to draw conclusions from extrinsic evidence to discern the intent of a new party. It is also important to note that this statute recognizes that this may impact investment performance, and permits ESG investment strategies regardless of the impact on performance.

Illinois has taken a different approach. Its revision to the prudent investor rule does not refer to the values or interests of either the grantor or the beneficiaries. Instead, the trustee is authorized to take into account "environmental and social considerations, [and the] governance

¹⁴ OR. REV. STAT. § 130.755(3)(i)-(j).

¹⁵ N.H. REV. STAT. ANN. § 564-B:9-902(c)(10).

policies of the entities in which the trustee may invest . . .”¹⁶ This approach allows the trustee to consider these attributes of particular investments as part of selecting investments as general considerations or factors for all trusts. It does not mean that the trustee can ignore the intent of the grantor or the interests of the beneficiaries, because those are part of the trustee’s overarching fiduciary duties. However, it treats ESG factors as objective factors for consideration in making investments rather than as a manifestation of the values of a particular person or group of persons. It is important to note, however, that this approach is not an invitation to a trustee to substitute their own subjective values for those of the grantor or beneficiary as that would represent an impermissible conflict of interest and a potential breach of the trustee’s duty of loyalty.¹⁷

The Prudent Investor Rule statutes typically provide that the grantor, through the terms of the trust, can modify the how the Prudent Investor Rule applies to the trust, or direct that it not apply.¹⁸ Drafting attorneys can include language both permitting consideration of ESG factors generally in investment decisions, and outlining the grantor’s intentions as to his or her own values or considerations, and how the trustee should evaluate and factor views of one or multiple beneficiaries in making investment decisions for the trust. By including specific clauses addressing this issue, the drafting attorney can ensure that the grantor’s intention can be carried out, regardless of the jurisdiction where the trust will be administered or changes in the law over time.

Sample language drafting attorneys can consider including for this purpose if the desire is to consider ESG investments as a permitted investment class might look like the following:

The Trustee is expressly authorized to acquire and retain investments not regarded as traditional for Trusts, including, without limitation, investments that integrate environmental, social and corporate governance (ESG) considerations, regardless of whether such ESG considerations and investments would otherwise be regarded as imprudent, improper, or unlawful under [insert specific reference to state law] or any applicable jurisdiction’s “prudent person” or “prudent investor” rule, and any such rule of applicable state law is expressly waived with respect to such investments. The Trustee has full discretion to engage in one or more sustainable, socially responsible or ESG investment

¹⁶ 760 ILL. COMP. STAT. 3/902(c)(7)-(8).

¹⁷ See Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 STAN. L. REV. 381, 381 (2020).

¹⁸ See, e.g., DEL. CODE ANN. tit. 12, § 3303.

strategies, in addition to, or in place of, other investment strategies.

For a grantor who wants to emphasize the role of the values of one or more beneficiaries in making ESG investment decisions, language like the following could be included:

When making investment decisions, the Trustee may consider the financial needs of the Beneficiaries as well as the Beneficiaries' personal values, including the Beneficiaries' desire to engage in ESG investment strategies that align with the Beneficiaries' values or beliefs.

In connection with this, the grantor might include additional guidance on how to balance the interests of the beneficiaries or to mandate a consensus statement of values. For example,

For purposes of identifying the values or beliefs of the Beneficiaries, the Trustee shall consider only [the interests of the Primary Beneficiary of the Trust] or [the Beneficiaries who are at the time an investment decision is made are permitted distributees of income] or [who are in the most senior generation of current Beneficiaries from time to time].

In the absence of language of this type, a trustee needing or wanting to consider the values of the beneficiaries of a trust in deciding on investment decisions will need to find a way to assess the collective values and opinions of the beneficiaries. This could take the form of a questionnaire to explore their varying interests or could be in the form of a family mission statement or statement of shared values. This can identify areas of common vision and guide the trustee in making ESG investment decisions. Trusts benefitting families that can identify a core set of shared values are the best candidates for pursuing ESG Investing.¹⁹

For grantors who want their own values to guide ESG Investing by the trustee, a statement of purpose included in the trust can guide the trustee. Consider the following example:

In making investment decisions for the assets of this Trust, I direct the Trustee to consider my strong devotion to [] during my lifetime, and affirmatively to seek out appropriate investments for the Trust that are consistent with these goals of mine which I believe will benefit the Beneficiaries in the long term.

A trustee provided with this guidance can make more informed decisions than one who is trying to discern the grantor's values after the

¹⁹ This approach is discussed in Amy E. Szostak, *A Fiduciary Perspective on Sustainable Investing*, TR. & EST., Feb. 2021.

grantor's death from looking at the investments in the grantor's own portfolio and other writings or behaviors exhibited during the grantor's life. Conversations directly with the grantor on the subject can also be invaluable to the trustee charged with ESG Investing. Estate planning professionals can facilitate these conversations between grantors and their chosen trustees by discussing the topics of ESG Investing with their clients, helping them organize their thoughts, and recommending and perhaps facilitating family discussions on the topic aimed at a family statement of values.

The objectives and guidelines for trustees investing trust assets have evolved over time, from a focus on the preservation of capital entrusted to them, to allocations among a narrow group of permitted investments, to the diversified portfolio maximizing its total return when the Prudent Investor statutes first appeared in the 1990s. A trust's portfolio today bears little resemblance to one from one hundred or even thirty years ago. ESG Investing represents the next evolution in investment decision making for non-trustee investors, and over time for trustee investment policies as shown by the states who have revised their statutes. Now is the time to explore this topic with your clients as they create new trusts so that their intentions can guide their selected trustees and provide financial as well as social and emotional well-being for their intended beneficiaries.

