Folks:

Take-Away: In the past year or so, the pendulum seems to be swinging away from ESG investing, but questions remain with regard to a trustee's fiduciary duties, especially when the trustee is pressed by trust beneficiaries to pursue an ESG investment strategy.

Background: Lots of questions surround what constitute environmental, social and governance (ESG) when selecting a Trust's investments. Recent studies suggest that the returns of ESG investments are at best 'iffy' when compared to non-ESG investments; ESG investments may not actually positively contribute to a portfolio's performance. Add to this lackluster investment performance is the frequent 'rap' against ESG investment that they can tend to 'greenwash' otherwise bad actors. Against this background some trustees are still asked to pursue ESG investments.

Fiduciary Duties: Beyond investment performance are the challenging questions that a trustee faces when requested by beneficiaries to consider, or not to consider, ESG factors when investing trust assets in the face of a trustee's various fiduciary duties. Specifically, the trustee's fiduciary duties of loyalty, impartiality, and care all can impact an investment strategy's use of ESG metrics. Should, or must, a trustee deliver both financial and non-financial benefits to the trust beneficiaries? To put a fine point on it, to what extent can a trustee allow for and honor the beneficiaries' wishes and still follow the settlor's intent?

Balancing Act: A trustee must balance the settlor's property interests, i.e., how the settlor's property is delivered to beneficiaries over time, with the interests of those impacted by the Trust, in short, its beneficiaries. ESG complicates the trustee's administration since the Trust must benefit the beneficiaries and comply with public policy, but that ultimate benefit does not need to be actual ownership of the specific trust assets themselves. Rather, the trustee must leverage the trust property to deliver an identifiable benefit that is consistent with the settlor's intent. This has sometimes been described as 'the settlor creating the skeleton of the trust relationship, and the trustee and the trust beneficiaries then 'fleshing out' the rest, while adhering to the settlor's initial bone-structure.' This 'fleshing out' might include the use of trust property to provide a non-financial benefit to the beneficiaries.

- **Non-Financial Benefits:** Some Trust instruments task the trustee to provide a non-financial benefit to the beneficiaries, by directing the retention of assets held for non-investment purposes, e.g., the family homestead or cottage, or a closely held business.
- **Emotional Benefits:** The emotional benefit of the item of property outweighs the financial in these directed-investment situations. EGS-focused investment strategies can offer a trustee the ability to provide the financial return of an investment strategy while potentially generating a beneficiary-specific, non-financial benefit, meaning the beneficiary's personal gratification of investing in line with his/her own values and interests. How, or even should, the trustee weighs these sorts of non-financial interests presents the challenge for the trustee when administering the Trust.

State Statutes: Some state statutes have authorized trustees to consider the values and beliefs of the Trust's settlor and/or the trust beneficiaries when acting as a prudent investor. Consequently, a beneficiary's non-financial interests in the trust property may impact a trustee's investment authority. Moreover, the trust laws of many states generally allow trust beneficiaries to have some influence over the Trust's administration, e.g., via a non-judicial settlement agreement, to the extent that it does not violate the Trust's material purposes. The problem is that with a beneficiary's involvement in trust investments, or the beneficiary's influence on the trustee, the perceived benefits cannot be easily quantified on a periodic trustee report. All of which leaves a trustee that pursues an EGS investment strategy uncomfortable, and potentially exposed to breach of trust claims if hindsight is applied to investment performance.

Conclusion: In the absence of specific direction from the settlor, the trustee must engage the trust beneficiary on a case-by-case basis if the beneficiary asks for an investment in an asset to secure a non-financial, e.g., emotional gratification, benefit. If a trustee is asked to make non-financial investments the trustee is strongly advised to include thorough documentation of each request, as well as its own analysis in the Trust's files and records.

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