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Legal Opinion 2021

Legal duties of New Zealand trustees to identify and manage climate change related investment risk

The Aotearoa Circle

Mā te Kaitiakitanga ko te Tōnuitanga
Prosperity Through Guardianship

The Aotearoa Circle has sought advice as to the legal duties of New Zealand trustees to manage climate change related risk to trust investments.

Co-authors Nicola Swan (Chapman Tripp) and Daniel Kalderimis (Thorndon and Richmond Chambers) conclude that trustees' duties of prudent investment, of impartiality towards beneficiaries, and to act in the best interests of beneficiaries all align in relation to addressing climate change investment risk. In light of the increasing awareness of climate-related risk in New Zealand in 2021, trustees will be expected to identify and assess whether climate-related risk may have a material impact on trust investments. While ever context-dependent, trustees should actively consider whether trust investments are at risk of material financial impact as a result of physical impacts or regulatory, market or legal developments connected to climate change. If so, then those trustees should appropriately manage that risk over the mid to long term, including by diversification and/or divestment if appropriate. These assessments are not easy, but they are important for trustees to work through to properly discharge their duties to present and future beneficiaries.

AOTEAROA CIRCLE LEGAL OPINION 2021: DUTIES ON TRUSTEES TO IDENTIFY AND MANAGE CLIMATE CHANGE RELATED INVESTMENT RISK

1 In October 2019, we published a legal opinion concluding that New Zealand company directors and managers of registered investment schemes were required to consider and manage material climate-related financial risk when taking business and investment decisions.[1] We now address the same questions for trustees: are trustees permitted or required to address climate-related financial risk when managing trust investments?

2 Since late 2019, recognition and understanding of the financial risks from climate change has markedly increased. New Zealand is passing legislation requiring all listed companies, large insurers, banks and investment managers to publicly disclose the risk that climate change poses to their businesses. Legal opinions around the Commonwealth align on the expectation that directors and pension fund managers – at least – must tackle climate-related financial risk head on.[2]

3 And so we do here for trustees in New Zealand in 2021.[3] We set out in the following three sections:

3.1 a brief overview of what trustees are now reasonably expected to understand about the impact of climate risk on investment performance;

3.2 the legal duties that require trustees to assess and manage material climate-related investment risk; and

3.3 our opinion on whether trustees may invest on the basis of moral or ethical drivers to take action on climate change, rather than financial or investment factors.

4 Our opinion is that trustees' legal duties of prudent investment, to act for the benefit of beneficiaries, and to act impartially as between beneficiaries, all align when considering their ability and obligation to make climate-related investment decisions. These duties are all context-dependent, and much in practice will turn on the size

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[1] Chapman Tripp (D. Kalderimis, N. Swan) *Climate change obligations for directors and scheme managers, legal opinion* (Aotearoa Circle, October 2019), available at https://chapmantripp.com/media/r30jdd05/climate-change-risk-legal-opinion-2019.pdf. See also *Chapman Tripp's Tool Kit for Directors: Managing Climate Risk in 2020*, available at https://chapmantripp.com/media/zynfua4g/managing-climate-risk-in-new-zealand-nov2020.pdf. The authors are grateful for the valuable insights of many within Chapman Tripp including in particular Andy Nicholls, Philippa Wilkie and Te Aopare Dewes as well as the research assistance of Emma Ricketts and Isla Doidge.

[2] Hutley and Davis "Climate Change and Directors' Duties" (7 October 2016) Centre for Policy Development <cpd.org.au>; Noel Hutley and James Mack *Superannuation Trustee Duties and Climate Change* (Memorandum of Opinion, February 2021); Bauslaugh "Climate Change: Legal Implications for Canadian Pension Plan Fiduciaries and Policy-Makers" (26 May 2021) McCarthy Tetrault www.mccarthy.ca.; Jeffrey WT Chan et al, *Legal Opinion on Directors Responsibilites and Climate Change under Singapore Law* (Legal opinion, 14 April 2021); see also a summary of multiple jurisdictions in Commonwealth Climate and Law Initiative and Climate Governance Initiative, *Primer on Climate Change: Directors' Duties and Disclosure Obligations* (June 2021).

[3] In this opinion we generally refer to trustees of express and private trusts under the New Zealand Trusts Act 2019, ie a trust that is intentionally established by a settlor, as opposed to a trust that arises by operation of law (such as a constructive trust) or by order of a court. Specific advice should be sought in relation to duties owed by trustees in accordance with the relevant trust deed, and particularly for trustees operating in a statutory context, eg under the Te Ture Whenua Māori Act 1993, the Māori Trustee Act 1953, the Trustee Companies Act 1967, the Public Trusts Act 2001, the Charitable Trusts Act 1957 and the Community Trusts Act 1999.

and sophistication of each trust and its asset mix. New Zealand's trust landscape is broad and varied,[4] and specific legal advice should be sought in each case, depending on the circumstances. In light, however, of the increasing understanding and awareness of climate-related financial risk in New Zealand in 2021, it is appropriate that trustees identify and assess this risk to determine whether it is likely to be material. Where it is likely to be material, trustees should appropriately manage that risk over the mid–long term, including by diversification and/or divestment of certain investments if appropriate. Trustees that fail to undertake any consideration of climate-related investment risk, where that risk is likely to be material, will be at risk of breaching their duties to beneficiaries.

I. What are New Zealand trustees reasonably expected to understand about climate risk in 2021?

5 Globally, the financial risk from climate change is understood with increasing sophistication.[5] New Zealand business, government, and communities have a much greater understanding of the risk from climate change to investment performance, including property, from regulatory developments in the last three years. This is particularly due to the release of the Climate Change Commission's 31 May 2021 advice to Government on how New Zealand's economy must change to reduce national GHG emissions to comply with emissions budgets that implement New Zealand's mandatory 2050 net zero emissions target,[6] and also the introduction of legislation implementing the recommendations of the global Task Force on Climate-Related Financial Disclosures (the *TCFD*).[7]

6 In relation to the latter, the Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill[8] aims to transpose the TCFD's widely-applauded recommendations into a New Zealand setting making climate-related financial risk a mandatory consideration for listed companies, large banks, insurers and fund managers caught by the Bill, with forward-looking "Climate Statements" publishable for financial years likely from FY 2022 - 2023 onwards. At the heart of this legislation is the goal that businesses better identify, understand, and manage the risks to their business that will materialise as a result of climate change. The ultimate aim being that investors and flows of capital are fully informed as to the full ambit of climate risks that, but for such disclosure, could be obscured.

7 Much is now understood about what climate-related investment risks actually are:

7.1 First, there are climate change induced physical risks estimated to wreak economic damage – such as the projected 0.5 to 1.1m sea level rises around

[4] See eg New Zealand Law Commission *Review of the Law of Trusts: preferred approach* (NZLC IP 31, 2012) at [1.3]; A Butler (ed) *Equity and Trusts* (2nd ed, Thompson Reuters, Wellington, 2009) at [5.2.1].

[5] In their 2019 update of their legal opinion regarding duties on Australian directors to consider climate-related financial risk, barristers Noel Hutley and Sebastian Davis referenced a "*profound and accelerating shift in the way that Australian regulators, firms and the public perceive climate risk*" (at [4]). In 2021, they re-emphasised these trends, noting the "*growing sense of regulatory, investor and community pressure for directors to understand...that the financial risks of a changing climate are to be taken seriously as economic and operational risks*" (at [3]).

[6] *Ināia tonu nei – a new low emissions future for Aotearoa* (June 2021) Climate Change Commission www.climatecommission.govt.nz.

[7] *Recommendations of the Task Force on Climate Related Financial Disclosures* (2017) TCFD www.fsb-tcfd.org. See also *TCFD Status Report* (October 2020) TCFD www.fsb-tcfd.org.

[8] Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill 2021 (30–1).

New Zealand's coastlines by 2100,[9] or the increased probability of higher temperatures and adverse storm events, as well as extreme flooding, drought and wildfires across the North and South Island.[10] Investments in businesses impacted by these physical risks may perform worse than expected. Moreover, primary sector businesses reliant on climatic patterns or protection from disease could find themselves facing considerable capital investment or location changes to continue expected production levels.

7.2 Second, there are risks to investments from the transition to a low-carbon economy, including major regulatory changes aligned with countries' commitments under the Paris Agreement – like New Zealand's forecast carbon prices up from today's $48 per tonne of CO_2e to in excess of $250,[11] the 2018 ban on offshore oil and gas exploration,[12] the anticipated transition to EVs,[13] or the transition away from coal usage in many existing boilers.[14] Transition risks also include major consumer, market and reputational shifts – like the risk of our European or Asian export markets deciding the emissions impact from freight tilts consumers away from far-flung exporters like New Zealand, or the emissions footprint of large-scale agriculture lowering demand for New Zealand lamb and dairy products.

7.3 The risk of litigation is also present and playing out in real terms for the alleged 'large' GHG emitters sued in the first climate change litigation brought against corporates in New Zealand as well as claims against the Government and the Climate Change Commission itself.[15]

8 While every investor must grapple with a different set of these risks with varying impact, the potential impact of these risks on global investments is increasingly well-understood and publicised:

8.1 In 2019, Mark Carney, ex-Governor of the Bank of England stated that £16tn of global investments were at risk from climate change.[16] At the same time, New Zealand's 2020 Cabinet Paper considering climate disclosures referenced

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9 *Coastal Hazards and Climate Change: guidance for local government* (Ministry for the Environment, December 2017) at 106.

10 *National Climate Change Risk Assessment for New Zealand* (ME 1506, Ministry for the Environment, August 2020).

11 *Ināia tonu nei: a low emissions future for Aotearoa,* above n 6, at 101 and 245; NZU price at 26 July 2021, available at www.carbonmatch.co.nz.

12 Crown Minerals (Petroleum) Amendment Act 2018.

13 Michael Wood and James Shaw "Clean car package to drive down emissions" (13 June 2021) Beehive.govt.nz www.beehive.govt.nz.

14 *Phasing out fossil fuels in process heat: National direction on industrial greenhouse gas emissions* (Ministry for the Environment, April 2021).

15 See eg *Smith v Fonterra Co-Operative Group Limited* [2020] NZHC 419 (Chapman Tripp acted for the defendants in this case and its appeal to the Court of Appeal in respect of which judgment is pending); *Lawyers for Climate Action NZ Inc. v The Climate Change Commission and Minister for Climate Change* (High Court, filed 1 July 2021) www.lawyersforclimateaction.nz.

16 Richard Partington "Mark Carney tells global banks they cannot ignore climate change dangers" *The Guardian* (online ed, 17 April 2019).

the US$7 trillion in global investments that will be required to have even a 50% chance of limiting warming to 2 degrees.[17]

8.2 According to the most recent global institutional investor surveys by EY and Deloitte, over 70% of investors devote considerable time and attention to evaluating climate-related risks when making asset allocation and selection decisions;[18] and 82% of organisations are concerned or very concerned about climate change.[19]

8.3 In New Zealand, PwC reported earlier this year that 65% of respondents had developed a responsible investing or ESG policy, with 66% ranking value creation as one of their top three drivers of responsible investing or ESG activity.[20]

9 Regulators' expectations of businesses' understanding of climate risk are rising. In Australia in February, the Australian Securities and Investment Commission (*ASIC*) identified disclosing and managing climate-related risk as a key investor responsibility.[21] The Australian Prudential Regulation Authority (*APRA*) has emphasised that climate risks should be managed like any other risk, and released draft guidance on climate-related financial risks for banks, insurers and superannuation trustees in April this year.[22] In November 2020, IFRS released guidance on assessment of material financial climate risks under existing IFRS Standards.[23]

10 In Europe, the European Central Bank has committed to incorporating climate change considerations in its monetary policy framework, and the European Banking Authority issued draft technical standards on disclosures on climate change and ESG-related risks in May 2021.[24] The UK completed formal consultation in May on the introduction of mandatory TCFD reporting from all large listed and private companies.[25] The UK Financial Conduct Authority has proposed extending an existing TCFD-aligned Listing Rule to all listed companies and to introduce TCFD-

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17 Cabinet Paper "Climate-related financial disclosures" (September 2020) available at https://environment.govt.nz/assets/Publications/Cabinet-papers-briefings-and-minutes/cabinet-paper-climate-related-financial-disclosures.pdf.

18 "How will ESG performance shape your future?" (July 2020) EY www.assets.ey.com at 5.

19 "2021 Climate Check: Business' Views on Environmental Sustainability" (2021) Deloitte www2.deloitte.com at 5.

20 "Private equity's ESG journey: From compliance to value creation" (2021) PwC www.pwc.co.nz.

21 Speech by Cathie Armour, ASIC Commissioner "Managing risk for directors" February 2021, https://asic.gov.au/about-asic/news-centre/articles/managing-climate-risk-for-directors/. Ms Armour emphasised ASIC's focus on ensuring listed companies have appropriate governance structures in place to address climate risk, and providing the market with reliable and useful information on their exposure to material climate-related risks and opportunities.

22 "Consultation on draft Prudential Practice Guide on Climate Change Financial Risks" (April 2021) APRA www.apra.gov.au.

23 "Effects of climate-related matters on financial statements" (November 2020) IFRS www.ifrs.org.

24 "ECB presents action plan to include climate change considerations in its monetary policy strategy" (8 July 2021) European Central Bank www.ecb.europa.eu; EBA publishes results of EU-wide pilot exercise on climate risk (21 May 2021) European Banking Authority www.eba.europa.eu; Directive 2014/95/EU on Non-Financial Reporting [2014] OJ L330.

25 UK Department for Business, Energy and Industry Strategy, *Consultation on requiring climate-related financial disclosures by publicly quoted companies, large private companies and limited liability partnerships* (March 2021) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/972422/Consultation_on_BEIS_mandatory_climate-related_disclosure_requirements.pdf.

aligned disclosure requirements to asset managers, life insurers and FCA-regulated pension providers.[26]

11 In the United States, Governor Lael Brainard of the US Federal Reserve recently noted that consistent, comparable and reliable disclosures will be important to manage exposure of both individual financial firms and the market to climate-related financial risks.[27] The US Securities and Exchange Commission, in a reversal of the previous administration's practice, has now started evaluating disclosure rules to facilitate the disclosure of information on climate change.[28]

12 Similar developments are underway throughout Asia. Hong Kong has announced that TCFD reporting will become mandatory not only for listed issuers (from July 2020) but also for banks, asset managers, insurers and pension fund trustees by 2025.[29] In Singapore a financial industry taskforce convened by the Monetary Authority of Singapore has launched several initiatives to accelerate green finance through TCFD disclosure.[30] The Japanese Ministry of Economy, Trade and Industry issued guidance on climate-related financial disclosures in 2018, which was updated by a private sector-led initiative in 2020.[31] The Central Bank of Malaysia and the Securities Commission of Malaysia have also issued similar guidance.[32]

13 Though detailed regulatory guidance has not yet been issued in New Zealand by the RBNZ or the FMA, we expect both to follow suit.[33] RBNZ has already indicated that it supports efforts to assess, manage and disclose climate-related risks. Similarly, NZX has expressed support for mandatory climate-related disclosures and already requires NZX Main Board issuers to disclose certain ESG-related matters in their annual reports as specified in its Corporate Governance Code, or explain why not.[34]

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[26] FCA consults on further climate-related disclosure rules (June 2021) FCA www.fca.org.uk.

[27] Speech by Governor Lael Brainard, Federal Reserve Governor "Financial Stability Implications of Climate Change" 23 March 2021, https://www.federalreserve.gov/newsevents/speech/brainard20210323a.htm.

[28] "Public Input Welcomed on Climate Change Disclosures" (15 March 2021) US Securities and Exchange Commission www.sec.gov.

[29] "Cross-Agency Steering Group Launches its Strategic Plan to Strengthen Hong Kong's Financial Ecosystem to Support a Greener and More Sustainable Future" (17 December 2020) Hong Kong Monetary Authority www.hkma.gov.hk.

[30] "Financial Institutions Climate-Related Disclosure Document" (May 2021) Monetary Authority of Singapore www.abs.org.sg.

[31] "Guidance on Climate-related Financial Disclosures" (December 2018) Ministry of Trade, Economy and Industry of Japan www.meti.go.jp.

[32] "BNM, Climate Change and Principle-based Taxonomy" (30 April 2021) Bank Negara Malaysia www.bnm.gov.my.

[33] Adrian Orr, Governor of the RBNZ has highlighted that "*climate change is a key risk to global financial stability*" which "*holds far-reaching implications for New Zealand's financial system*" (Speech by Adrian Orr, RBNZ Governor "Progessing Climate Action by Driving Transformational Change" (October 2020) https://www.rbnz.govt.nz/research-and-publications/speeches/2020/speech2020-10-28). Rob Everett, Chief Executive of the FMA, stated that the NZX intends to "*ensure that listed issuers consider the risks (and opportunities) to their business models and profitability from climate change*" (Speech by Rob Everett, FMA Chief Executive "FMA – the year ahead" (February 2020) https://www.fma.govt.nz/news-and-resources/speeches-and-presentations/rob-everett-speaking-at-the-financial-services-council-breakfast/).

[34] NZX "Submission to the Economic Development, Science and Innovation Committee on the Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill 2021" at [7]; NZX Ltd "NZX Listing Rules" (1 January 2019), r 3.8.1; NZX Ltd "NZX Corporate Governance Code" (10 December 2020), r 4.3. Specific reference to TCFD disclosure is contained in the NZX ESG Guidance Note (10 December 2020), Part 4.

14 New Zealand's largest asset owners and investment managers – the Guardians of New Zealand Superannuation (for the NZ Super Fund) and ACC – are also driving the conversation forward on management of climate risk. The NZSF published its Climate Change Investment Strategy in June 2020, and its first voluntary TCFD report in October 2020. It has taken a four-pronged approach to managing climate-related financial risk in its $45b investment portfolio, which includes reducing the Fund's exposure to fossil fuel reserves and carbon emissions through ongoing engagement with companies; building carbon measures into its investment model and targeted divestment; incorporating climate change considerations into investment analysis and decision-making; and intensifying efforts to search for new investment opportunities in the areas of alternative energy, energy efficiency and transformational infrastructure. Many New Zealand banks, insurers, energy companies and other listed companies are now also disclosing their climate-related financial risk on a voluntary basis, thereby raising the corporate bar to meet consumer expectations.

15 Pension fund trustees have already been singled out for failure to manage climate risk. In the UK, new legislation has been passed requiring trustees to assess, manage and monitor the impact of climate-related risks on their scheme on an ongoing basis, and to publish an annual report online.[35] In December 2016 the EU adopted the IORP II Directive which requires pension providers to carry out risk assessments (including as to climate-related risks) every three years or after any significant change in the pension fund's risk profile.[36] In 2021, Noel Hutley and James Mack updated their 2017 legal opinion to conclude that, in order to act prudently and in the best financial interests of beneficiaries, Australian superannuation trustees must ensure their processes, structures and expertise are responsive to financial risk posed by climate change.[37] A major pension scheme was sued in a high-profile claim in Australia last year for failure to disclose climate risks to its long-term investments.[38]

16 Against the above backdrop, investors in coastal property in New Zealand, or property in low-lying or flood prone areas (whether from sea level rise, surges or pluvial flooding) are already asking questions about the likelihood and impact of flood risk over the life of the property. Many property owners do not yet actively engage with these longer-term risks. But trusts, by their nature, have a long-term horizon. Mortgage requirements, insurance, and even LIM reports are likely to raise a climate risk at important moments, such as when a sale eventuates. Some local councils have been caught in litigation when trying to disclose climate risk on LIM reports,[39] while central government is now indicating that a national approach to climate risks will be taken through consideration of planning requirements, potential

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[35] The Occupational Pension Schemes (Climate Change Governance and Reporting) (Miscellaneous Provisions and Amendments) Regulations 2021. These requirements will come into force on 1 October 2021.

[36] Directive (EU) 2016.2341 of the European Parliament and the European Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs).

[37] Hutley and Mack, above n 2, at [2].

[38] Mr McVeigh, an Australian pension fund member, asserted that the Retail Employees Superannuation Trust had violated the Corporations Act 2001 by failing to provide its beneficiaries with information related to climate change business risks and plans to address those risks. The parties settled, with REST agreeing to implement a net-zero by 2050 goal, report in line with TCFD and encourage investee companies to disclose climate-related risk.

[39] *Weir v Kapiti Coast District Council* [2013] NZHC 3516.

compensation, insurance and other policy proposals under the umbrella of the proposed Managed Retreat and Climate Change Adaptation Bill.[40]

17 The above is just a snapshot of developments that are relevant to whether and if so, how far, trustees are required to take climate change into account when taking investment decisions. In the sections below we consider whether it is permissible and/or mandatory for trustees in New Zealand to consider climate-related risks and opportunities when acting as trustee and, if so, to what extent.

II. Do trustees' fiduciary and statutory duties allow and/or require them to manage climate risk?

18 From 30 January 2021, trustees' duties in New Zealand are codified via the Trusts Act 2019, which brings together trustees' common law duties and statutory duties contained in the (largely repealed) 1956 Trustee Act.[41] In any analysis of trustee duties, the most commonly cited duties are the (mandatory) duties to act honestly and in good faith, to know and act in accordance with the terms of the trust, and the (default) general duty to exercise reasonable care and skill.[42]

19 When considering trustees' powers of investment and consideration of climate risk, the key duties are:

19.1 the duty of prudent investment;[43]

19.2 the duties to act in the interests – often referred to as the "best interests" – of beneficiaries, and for a "proper purpose";[44] and

19.3 the duty of impartiality as between all beneficiaries.[45]

20 We explain below the impact of each of these duties on trustees' obligations in relation to climate change. The most obvious is the duty of prudent investment.

The duty of prudent investment

21 Trustees must decide whether and how to invest trust funds, including whether to invest in share portfolios, commercial or residential property. When investing trust property, New Zealand trustees must (unless the duty is modified or excluded by the trust deed)[46] exercise the skill and care that a "*prudent person of business*" would exercise when managing others' affairs.[47] Where the trustee is a professional

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40 "Overview of the resource management reforms" (June 2021) Ministry for the Environment www.environment.govt.nz.

41 See the transitional provisions in sch 1 of the Trusts Act 2019.

42 Trusts Act 2019, ss 23, 24, 25 and 29.

43 The duty of prudent investment is a default duty which many be modified or excluded by the Trust Deed: see Trusts Act 2019, ss 28 and 30.

44 Both of these duties are mandatory duties: Trusts Act 2019, ss 22, 26 and 27.

45 The duty of impartiality is a default duty which many be modified or excluded by the Trust Deed: see Trusts Act 2019, ss 28 and 35.

46 Trusts Act 2019, s 28.

47 Trusts Act 2019, s 30. The duty to invest trust property with the care and skill that a prudent person of business would exercise in managing the affairs of others is dis-applied to the managers of schemes which are registered under the Financial Markets Conduct Act 2013 (*FMCA*): Trusts Act 2019, ss 30 and 170; FMCA, s 155A. The relevant standard of care expected is therefore not technically a prudent *investment* standard but the generic prudent professional standard of care in s 144 FMCA: a professional manager must, in exercising any powers or performing any duties, exercise the care, diligence and skill that a prudent person engaged in that profession would

trustee, this is elevated to include any special knowledge or experience that it would be reasonable to expect from their professional status.[48]

22 The assessment of what a prudent businessperson would do is an objective test, although a flexible one, as it is evidently contextual and time-dependent. It is a standard which will "*change with economic conditions and in the light of contemporary thinking and understanding".*[49] It is also anchored to what a prudent person would do *not* when managing their own affairs, but when managing the affairs of others.[50]

23 The 2019 Act has broadened the range of matters which a trustee may take into account when exercising a power of investment. As well as considering the desirability of diversification, risk and likely return, the 2019 Act now expressly permits a trustee to consider the trust's objectives or purpose and the trustee's overall investment strategy.[51]

24 These broader criteria reflect the New Zealand courts' approach when asked to review trustee investment decisions. In the 2007 case of *Kain v Hutton*, when describing a trustee's duty to act in the interests of the beneficiaries (discussed further below), the Court of Appeal explained that the duty was a "*holistic one*" which involves consideration of factors which "*may well conflict with profit maximisation*", specifically citing the trust's purpose, diversity of investment, risk management and a balance between capital growth and income yield.[52]

25 This holistic approach moves subtly beyond the more conservative approach earlier taken for example in *Jones v AMP* in 1993*,* which confirmed that, typically, the power of investment "*must be exercised so as to yield the best return for the beneficiaries, judged in relation to the risks of the investments in question*".[53] While the relative rigidity of this approach can be explained by the context of the facts in *Jones,* which involved a challenge to a superannuation fund manager's decision to heavily invest in one of its parent company's managed funds, subsequently hit hard by the 1987 share market crash, the holistic approach permits a wider assessment of what might be relevant to any particular investment decision. This is reconfirmed by the 2019 Act.

26 Importantly, the courts' focus is not on ultimate investment performance. The standard remains one of conduct, not of outcome.[54] The courts will focus on the

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exercise in the same circumstances. We do not see this as a material difference for practical purposes.

48 Trusts Act 2019, s 30(b).

49 *Re Mulligan (Deceased)* [1998] 1 NZLR 481 at 501.

50 *Re Whiteley* (1886) 33 Ch D 347 at 355.

51 Trusts Act 2019, s 59. (Overall investment strategy was referred to separately within the 1956 Act, s 13M, as a matter the court could take into account in an action for breach of trust).

52 *Kain v Hutton* [2007] NZCA 199 at [31], citing *Cowan v Scargill* [1985] Ch 270. Justice Glazebrook stated *"the focus of trustees must be on prudently managing and investing the trust's assets. The duty to act in the best interests of the beneficiaries is a holistic one which involves considerations of the trust's purpose, diversity of investment, risk management and a balance between capital growth and income yield … These considerations may well conflict with profit maximisation…*".

53 *Jones v AMP Perpetual Trustee Company NZ Ltd* [1994] 1 NZLR 690 (HC) at 706, citing *Cowan,* above n 52. The concern being dealt with by Thomas J was whether the trustees had invested prudently on purely financial (rather than ethical) considerations, and whether the trustees had infringed the rule against personal profit. See 695-698 and 705-706.

54 *Jones* at 706.

process by which the investor adopted, implemented and monitored investment strategies, and not on the outcomes of those strategies.[55] Similarly, investment decisions are judged at the time of the investment, not with hindsight.[56] As expressed by Andrew Butler, a trustee is accountable for the way they have used their powers, not for legitimate risks, market forces and other uncontrollable impacts on the trust funds.[57]

27 This approach is reinforced by the 2019 Act, which states (as did the 1956 Act[58]) that, in any claim against a trustee for breach of duties, the court may consider:[59]

27.1 whether the trust investments have been diversified, so far as is appropriate under the terms of the trust; and, importantly,

27.2 whether the investment was made pursuant to an investment strategy formulated in accordance with the duty of care under the relevant legislation.

28 Ultimately this means that trustees must take prudent and careful investment decisions in the context of what is known and expected at that time. This is why the fast pace of development of understanding of climate risk set out in Section I above is so relevant. In our view, a prudent businessperson cannot credibly claim that her legal duties prevent her from considering climate change when making investments, or that climate change is not a financial risk to be taken seriously. As we identified in our 2019 opinion in relation to scheme managers, the reasonable and prudent course – and the one likely to secure the best realistic return over the long term – requires assessment of *any* financial risk that is material.[60] In many cases, depending on the reasonable judgement of the trustee, this now requires assessment of, and an appropriate response to, material climate-related financial risk.

29 Accordingly, the duty of prudent investment is likely to require trustees to:

29.1 identify climate-related financial risk for trust property and investments (such as whether share portfolios are heavily weighted to oil and gas assets, or to a particular emissions-intensive industry);

29.2 seek and act on expert advice where necessary (such as whether residential property is exposed to significant flood risk that might impact insurability in the next 20 years);[61] and

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[55] RL Davis and G Shaw *Trustee Investment: The Prudent Person Approach* (2nd ed, Butterworths, Wellington, 1997) at 37.

[56] *Jones,* above n 53, at 706*; "[I]t is clear that a trustee is neither an insurer not guarantor of the value of a trust's assets and that the trustee's performance is not to be judged by success or failure, that is, whether he or she was right or wrong. While negligence may result in liability, a mere error of judgment will not."*

[57] Butler, above n 4, at [8.2.3], citing *Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 Ch 515 at 531, where Brightman J talks of a prudent degree of risk. See also *In re Godfrey* (1883) 23 Ch D 483 at 493.

[58] Trustee Act 1956, s 13M.

[59] Trusts Act 2019, s 128.

[60] Kalderimis and Swan, above n 1 at [168].

[61] *Cowan,* above n 51, at 289; *Jones,* above n 52, at 25; *New Zealand Maori Council v Foulkes* [2014] NZHC 1777 at [180].

29.3 assess and manage that climate-related financial risk for the benefit of the beneficiaries.

30 While these considerations do not require knee-jerk reactions, they do mean that trustees should be thoughtful about where to invest property over the longer term. While the duties are the same for all trustees, the way in which they are applied by the courts is context-dependent. Greater sophistication is generally expected of trustees of large commercial trusts than of trustees of small family trusts. What is important here is the focus on property and the very real physical risks climate-related factors pose for certain property investments. Moving beyond our 2019 opinion, we consider that these factors have become more urgent and demanding given the regulatory developments described at Section I above.

The duty to act for the benefit of the beneficiaries and for "a proper purpose"

31 Having determined that the duty of prudent investment requires prudent assessment and integration of material climate-related financial risk, the next question is whether trustees are hampered in their investment management by their duty to act "*for the benefit*" of the beneficiaries and "*for a proper purpose*". A conservative and perhaps traditional assessment is that trustees' duties might require them to *exclude* climate change considerations from investment decisions on the assumption that factoring in climate change – whether by withdrawing from high-emissions investments or favouring low-emissions investments – might *lower* financial performance.

32 Questions are still asked by investment managers and trustees as to whether they are able to shift funds into environmentally sustainable investments to reflect their own values or those they perceive of the beneficiaries, but where they perceive investment returns may be lower. The concern is that doing so might not be aligned with beneficiaries' best interests, or not be for a "proper purpose" under the trust deed, but be an extraneous – if laudable – purpose.

33 In our view, these concerns fall away where climate-related financial risk is potentially material to investment performance. For the same reasons as set out above, the duty to act for the benefit of the beneficiaries, or in the best interests of the beneficiaries, not only *allows* trustees to consider climate-related financial risk, but *requires* trustees to properly assess all potentially material financial risks, including such risks impacting investment performance that are linked to climate change.

34 The Trusts Act 2019 requires that trustees deal with trust property and otherwise act "*for the benefit of the beneficiaries*", in accordance with the terms of the trust.[62] In addition, the Act states that trustees must exercise trust powers *"for a proper purpose"*.[63] Both are mandatory duties that may not be modified or excluded by the terms of the trust.[64] The statutory wording is different to the obligation on directors to act in the "*best interests*" of the company, and for fund (scheme) managers to act in the "*best interests*" of investors in the fund,[65] but we do not draw a major

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62 In the case of a trust with a permitted purpose, the trustees must act to further this permitted purpose, in accordance with the terms of the trust: s 26(b).

63 Trusts Act 2019, s 27.

64 Trusts Act 2019, s 22.

65 Companies Act 1993, s 131; FMCA, s 143(1)(b)(i).

distinction here: the case law regarding trustee duties deals interchangeably with the "interests" and the "best interests" of the beneficiaries. (Trustees are also always required to act honestly and in good faith, as explained above.[66])

35 As recognised most recently in commentary on the Trusts Act 2019, a trustee's duty to act in the interests of the beneficiaries and to exercise their powers for a proper purpose have been recognised as being "*the opposite sides of the same coin*".[67] The trustee needs to identify what the beneficiaries' interests are, and to make sure that she is acting in their best interests, and not the interests of the trustees or others in the community. In order to identify the beneficiaries' interests, the trustee must look to the trust deed itself, and, as appropriate, any memorandum of wishes from the settlor of the trust. The trust deed also informs what a 'proper' purpose of any action might be.

36 The duty to act for the benefit of the beneficiaries is judged by an objective standard.[68] Where the purpose of the trust is to provide financial benefits for the beneficiaries, which will usually be the case subject to express wording in the trust deed, the best interests of the beneficiaries will be their best financial interests.[69]

37 One of the leading cases on trustees' duties to act for the benefit of the beneficiaries remains the 1985 decision of *Cowan v Scargill*.[70] The English High Court famously refused to permit union-appointed trustees to pursue an investment policy aligned with their political interests (prioritising domestic coal mining). Vice-Chancellor Sir Robert Megarry considered that beneficiaries' best interests were normally their best financial interests and that in investing on behalf of beneficiaries trustees must put aside their own personal interests and views.[71] The Court held that trustees must not pursue elective 'policies of prohibition' unless the investments are demonstrably objectionable to actual and potential beneficiaries.

38 However, *Cowan* did not hold that trustees must act only in the beneficiaries' exclusive immediate financial interests or say that trustees cannot make decisions informed by the beneficiaries' values (particularly where they have opted for such an approach in the trust deed or offer documents). The Court accepted that it would be possible – albeit "*very rare*" – to invest on grounds other than pure financial grounds if all beneficiaries had consented or where the trustees could be sure they would so consent.[72] Despite a subsequent willingness to see *Cowan* as endorsing a profit

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66 Trusts Act 2019, s 25.

67 *Merchant Navy Ratings Pension and Anor v Stena Line Ltd and Ors* [2015] EWHC 448 (Ch) [*The Stena*] at [229] per Asplin J. See Jeff Kenny and Prof. Jessica Palmer, "Variations, Resettlements and Winding Up Trusts" in *NZLS Trusts Conference 2019* at 246.

68 In *Nestle v National Westminster Bank Plc* [1993] 1 WLR 1260 at 1270 the Court expressly noted "*The court has to look objectively at the circumstances, to see if there are in fact good and sufficient reasons for supporting the decision*". See also the discussion of 'best interests' obligation in *ASIC v Australian Property Custodian Holdings Ltd [No 3]* [2013] FCA 1342 at [464] onward and [485] – [488].

69 *Cowan,* above n 51, at 287.

70 *Cowan,* above n 51.

71 *Cowan,* at 287.

72 *Cowan,* at 288–289: "…*The beneficiaries might well consider that it was far better to receive less than to receive more money from what they consider to be evil and tainted sources. "Benefit" is a word with a very wide meaning, and there are circumstances in which arrangements which work to the financial disadvantage of a beneficiary may yet be for his benefit … But I would emphasise that such cases are likely to be very rare, and in any case I think that under a trust for the provision of financial benefits the burden would rest, and rest heavy, on him who asserts that it is for the benefit*

maximisation duty on trustees, read carefully, *Cowan* merely confirms that fiduciary powers must be exercised "*carefully and fairly for the purposes for which they are given and not so as to accomplish any ulterior purpose*".[73] Indeed, the judgment observed that what is considered the best return for beneficiaries must be "*judged in relation to the risks of the investment in question*".[74]

39 Case law following *Cowan* has not adopted a crude profit maximisation approach in interpreting the obligation to act in the interests of beneficiaries. In the subsequent 1988 Scottish decision of *Martin v City of Edinburgh District Council* the Court recognised the principles in *Cowan*. In finding that a trustee had breached its duties to act in the beneficiaries' best (financial) interests by implementing an anti-apartheid policy in its investment planning (which, ironically, improved performance as a result), the Court reemphasised that trustees must not fetter their investment discretions with political or moral judgments lacking a financial basis. The Court did, however, take a pragmatic view, adopting a realistic understanding that it was not reasonable or practicable to expect a trustee to divest himself of "*all personal preferences, of all political beliefs, and of all moral, religious or other conscientiously held principles*" when making trust decisions: instead a trustee should "*recognise that he has those preferences, commitments or principles but nonetheless do his best to exercise fair and impartial judgment on the merits of the issue before him*". In addition, the Court noted that there was a difference between a trustee and a financial adviser, and that trustees did not have a duty to simply invest, without qualification, in the most profitable investments available, or to "*rubber stamp*" the recommendation of a financial adviser.[75]

40 These decisions show that, while trustees will usually need to take prudent investment decisions in the best financial interests of the beneficiaries, identification of what the beneficiaries' financial interests are is not limited to dogged profit maximisation on an investment-by-investment basis. It is instead pragmatic, and can include a long-term view. In our view, this requires a proper assessment of financially material risks to trust investments, including climate change.

41 This is reflected in the more recent decisions. In 2015, the English High Court was required to consider the relationship between the beneficiaries' interests and the proper purposes of the trust.[76] There, in finding that changes to an industry-wide pension scheme which distributed financial obligations more fairly between different employers would *not* be in breach of the trustees' duties, the Court reemphasised that the best interests of the beneficiaries should "*not be viewed as a paramount stand-alone duty*" but instead depended on what the purposes of the trust were.[77]

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of the beneficiaries as a whole to receive less by reason of the exclusion of some of the possibly more profitable forms of investment."

[73] See discussion in UNEP Finance Initiative "A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment" (2005) at 6.

[74] *Cowan,* above n 52, at 287.

[75] *Martin v City of Edinburgh* [1988] SLT 329 (CSOH) at 334.

[76] *The Stena,* above n 66.

[77] The Court stated: *"It is necessary first to decide what is the purpose of the trust and what benefits were intended to be received by the beneficiaries before being in a position to decide whether a proposed course is for the benefit of the beneficiaries or in their best interests. …it is clear from Cowan v Scargill that the purposes of the trust defines what the best interests are and that they are opposite sides of the same coin." The Stena,* above n 68, at [228]–[229].

42 The Court also cited with approval earlier observations of Sir Richard Scott VC in *Edge v Pensions Ombudsman*.[78] In that case, dealing with the proper treatment of a pension fund surplus, the Court had accepted that the trustees were justified in taking into account the broader interests of the employers participating in the scheme – as opposed to solely considering the beneficiaries' financial interests.[79] Using similar reasoning, Asplin J was willing to recognise that acting in the best interests of the beneficiaries did not necessarily equate to taking the course of highest profits.[80]

43 These approaches reflect the holistic approach beyond pure "*profit maximisation*" taken by the New Zealand Court of Appeal in *Kain v Hutton,* above.[81] In this vein, the High Court was even willing, in 2016 in *Re Vella,* to displace the "*heavy burden*" that "*financial interests will be considered paramount*" in specific circumstances where trust arrangements were in fact for the beneficiaries' immediate financial disadvantage.[82]

44 The caselaw therefore recognises that trustees are permitted to take a broader approach than immediate profit maximisation when acting in the best interests of beneficiaries and taking investment decisions. The 'holistic' view permits trustees to take a reasonable view of what will benefit the beneficiaries over the longer term. This is important for trustees with different classes of beneficiaries, and particular stated intentions within the trust deed or the memorandum of wishes.

45 Whether this allows trustees to take investment decisions based entirely on climate-related moral or ethical drivers is dealt with at Section III below. But where climate-related investment risks are potentially financially material, it is clear that trustees need to take these risks into account when acting in the beneficiaries' financial interests. In this regard, the best interests duty *aligns* with the duty of prudent investment, although it is the duty of prudent investment that articulates more clearly what it is reasonable for a trustee to take into account.

The duty of impartiality as between beneficiaries – including the protection of intergenerational equity

46 Thirdly, trustees must balance the interests of all beneficiaries, most often played out as between the interests of a beneficiary receiving regular payments over the course of their lifetime, and the interests of ultimate or residual beneficiaries that stand to gain in future from capital appreciation. These competing interests become more complex where there are unborn grandchildren or unascertained beneficiaries.

47 Section 35 of the Trusts Act 2019 requires that (unless modified or excluded by the trust deed),[83] trustees must act impartially in relation to the beneficiaries, and must

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[78] *Edge v Pensions Ombudsman* [1998] Ch 512 at 537. On appeal, Richard Scott VC's comments on this issue were cited with approval: [1999] 4 All ER 546 at 560–561. See also *The Stena,* above n 68, at [231]–[235].

[79] *Edge* [1998], above n 77, at 537, *Edge* [1999], above n 77, at 560–561 and *The Stena,* above n 66, at [231]–[235].

[80] *The Stena,* above n 66, at [234]–[235].

[81] *Kain,* above n 52, at [31], again, citing *Cowan,* above n 51.

[82] The Court recognised that the trustees were seeking to balance the preservation of family relationships and beneficiaries' interests, but only after recognising that the beneficiaries had consented to the lesser or non-recovery of interest, and could thus be "*taken to have indicated that their best interests encompass considerations that extend beyond strict financial gain*". *Re Vella* [2016] NZHC 1130 at [28].

[83] Trusts Act 2019, s 28

not be unfairly partial to one beneficiary or group of beneficiaries to the detriment of the others. This does not require a trustee to treat all beneficiaries equally, but all beneficiaries must be treated in accordance with the terms of the trust.[84]

48 This duty of impartiality requires a clear appreciation by the trustees of the impact of their decision-making on ultimate beneficiaries. This is not new: in *Cowan v Scargill* the English High Court affirmed the principle that the trustees of a pension scheme have a duty to exercise their powers in the best interests of the present *and future* beneficiaries.[85] In *Re Mulligan,* the New Zealand High Court held that trustees had breached their duty of impartiality in their investment choices by favouring the deceased's widow over the deceased's children, stating that: "*It is elementary that a trustee must act with strict impartiality and endeavour to maintain a balance between the interests of the life tenant and the remaindermen. Put another way, a trustee must be even-handed as between income and capital beneficiaries*."[86]

49 Execution of the duty to act impartially can be difficult when balancing the claims of different classes of beneficiary, and the courts have recognised this tension. In *Nestle v National Westminster Bank plc* Justice Hoffman in the English Court of Appeal preferred the approach that trustees must act fairly in making investment decisions which may have different consequences for different classes of beneficiaries, rather than the traditional image of holding scales equally between a tenant for life and beneficiaries entitled to the remainder.[87] As above, *Edge v Pensions Ombudsman* is an example of the trustees preferring certain beneficiaries over others, albeit where permitted to do so by the trust deed.[88] Similarly in *Manukau City Council v Lawson* the New Zealand High Court stated that trustees exercising discretionary powers could prefer some beneficiaries over others, so long as they were not taking into account irrelevant, irrational or improper factors.[89]

50 While any assessment will depend on the particular classes of beneficiaries under the relevant trust deed, our opinion is that the duty of impartiality supports the need for trustees to assess and manage climate risk in cases where climate-vulnerable investments may threaten the long-term value of the trust property despite producing acceptable returns in the short-term. As such, this duty strengthens and clarifies the obligation to invest prudently and to act in the best interests of beneficiaries. By its very nature, the duty of impartiality supports a long-term perspective when making investment decisions for the benefit of all beneficiaries in a way that the duty of prudent investment *might* not recognise to the same degree. This would be particularly relevant where trust property is held for multiple generations, where the trust is created to last for a long period of time (i.e. into

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84 Trusts Act 2019, s 35(2).

85 *Cowan*, above n 51.

86 *Re Mulligan,* above n 48, at 501.

87 *Nestle,* above n 67 at 4–5.

88 *Edge* [1999], above n 79, at 565 and 575. See in the New Zealand context *Manukau City Council v Lawson* [2001] 1 NZLR 599 (HC) and *Lee v Torrey* [2015] NZHC 2135 at [86]-[88].

89 *Manukau City Council,* above n 89, at [31]. There, Justice Paterson recognised that the duty of impartiality applied more obviously where the rights of the life tenant and the remaindermen were set out in the trust deed.

perpetuity),[90] or where a trustee is managing assets for multiple beneficiaries' interests that become active at different times.[91]

51 Longer-term management of climate risk has already been identified overseas as central to the management procedures of pension fund trustees, whose investments are long term by their very nature. In their 2017 and 2021 legal opinions, barristers Noel Hutley SC and James Mack concluded under Australian law that:[92]

51.1 in order to comply with obligations under the superannuation law, a superannuation trustee needs to ensure its processes, structures and expertise are responsive to the financial risk posed by climate change, because that risk is ascertainable and also likely to be material; and

51.2 trustee directors should source, consider and weigh relevant information relating to climate change risk, record their decision-making processes, and actively manage climate investment risk where necessary.

52 Hutley and Mack recognised that pension plan fiduciaries must recognise and balance current and future intergenerational risk and return considerations over extended time periods.[93] This Australian approach also reflects the UK's Pension Schemes Act 2021, which now requires pension fund trustees to understand how to identify, assess and manage climate-related risks, and to maintain oversight and assessment of relevant risks to their scheme.[94] The same duties could easily apply to trustees with a long trust duration.[95]

III. Do trustees' duties allow them to take decisions based on climate change risk where there is no clear financial impact on trust property?

53 Finally, we consider whether trustees' duties allow them to take decisions based on climate change risk where there is no clear financial impact on trust property, or where there may even be a negative impact on investment performance. This challenges traditional understandings that trustees acting in the best financial interests of their beneficiaries should *not* take ethical or moral views into account where to do so might lower the financial performance of the investments.

54 As above, it is clear that the courts will accept a broad range of considerations when reviewing investment decisions, including the objectives of the trust or the permitted

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90 Examples include trusts that are "post-settlement governance entities" and established for Treaty of Waitangi Settlements, where the relevant Treaty Settlement legislation usually specifically provides an exemption from the rule against perpetuities (Ngāti Whātua Ōrākei Claims Settlement Act 2012, s 20); and Māori land trusts established under the Te Ture Whenua Māori Act 1993, where s 235 provides that "*No trust constituted under this Part shall be subject to any enactment or rule of law restricting the period for which a trust may run*".

91 For example, the duty of impartiality also applies to trustees of Māori land trusts under the Te Ture Whenua Māori Act 1993, in addition to a duty to carry out any special purposes that may be required under that Act (eg. to apply income for community purposes): Māori land trustees are "*under the same obligations as other trustees to, for example, act impartially and fairly between beneficiaries, prudently invest trust funds, and to act jointly*": Jacinta Ruru "Equity and Maori" in Butler, above n 4, at [43.2.7].

92 Noel Hutley and James Mack *Superannuation Fund Trustee Duties and Climate Change Risk* (Memorandum of Opinion, June 2017) at [3.3]; Hutley and Mack, above n 2, at [2].

93 Hutley and Mack, above n 2, at [5]-[8]; Bauslaugh, above n 2.

94 The Occupational Pension Schemes Regulations 2021, above n 34. See also in Australia – Superannuation Industry Supervision Act 1993 (Cth), s 52 and ISO 31000:2019 – risk management guidelines.

95 See eg above, n 37.

purposes of the trust. But where the objectives or permitted purposes are not specified, or the trustees do not otherwise have a clear mandate, the courts will be less willing to accept the trustees making investment decisions based on their impression of the beneficiaries' ethical or moral views.

55 This played out in the 1993 decision in *Harries v Church Commissioners for England*, where the English High Court refused a claim that the Church Commissioners had breached their duties by not focussing enough on the promotion of the Church.[96] The Court was prepared to accept that there might be rare cases where an investment conflicted with "*the very objects their charity is seeking to achieve…*", but said that, otherwise, trustees would not be entitled to take into account non-financial criteria except where the trust deed so provided.[97] The Court did however endorse the Commissioners' detailed ethical investment policy, which included exclusions and some pro-active (but limited) direct investment (in local businesses), so long as such considerations did not "*significantly jeopardise or interfere with accepted investment principles*".[98]

56 While there are no New Zealand cases specifically on point, it is worth noting that there has been recognition in New Zealand case law that the beneficiaries' best interests must not be confused with the best interests of the beneficiaries' wider community. Two Māori Land Court decisions reinforce this principle:

56.1 In the 2011 decision *Re Tawhai* the Court critiqued the trustees of a Māori Land Trust for being diverted from their primary function of ensuring the protection of the land and a proper return on investments, warning that: "*In particular, the problem is that the trustees have invested in businesses for reasons that appear to be more to do with community, social or historical imperatives than because they will produce the best financial return for the owners. That is not to say that the Trust cannot have community purposes in mind in making investments, but their primary duty is to ensure that they are building up the assets and income for the owners*." [99]

56.2 The Court made similar comments again in 2014 in *Re Corrigan - Ngatihine* in the context of social housing investments supporting the broader community that were made by trustees with trust funds meant to provide for the beneficial owners.[100] In determining that the trustees had not acted prudently the Judge noted that, while the social housing investment was "*laudable*", "*there is a real risk in the present circumstances that the interests of the beneficial owners will be compromised in order to benefit the wider Māori community*".[101]

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96 *Harries v Church Commissioners for England* [1993] 2 All ER 300.

97 *Harries* at 308. Similarly in *Cowan,* above n 51, at 288 the Court was willing to accept that the beneficiaries' strongly held known views might justify the trustees excluding certain investments in clear circumstances but this was expected to be fairly rare.

98 *Harries* at 308.

99 *Re Tawhai – Waima North A22* (2011) 29 Taitokerau MB 212 (29 TTK 212) at [25]–[26].

100 *Re Corrigan – Ngatihine H2B* (2014) 71 Taitokerau MB 72 (71 TTK 72).

101 At [40]. The trust was an ahu whenua trust under the Te Ture Whenua Māori Act 1993, which holds land and assets in trust on behalf of the beneficial owners, but not in for the benefit of the general Māori community. The Court stated at [41]: "*I have no doubt that many beneficial owners support the Trust's initiative. But the trustees have the ultimate responsibility to ensure any investment is appropriate*".

57 These considerations could be different in the specific cases of a community trust or a charitable trust, both of which are likely to have clearly articulated purposes.[102] For example, property held in a community trust must be held for specific charitable or other purposes and applied for purposes that are beneficial to the local community.[103] These could therefore justify investment with a particular sustainability focus.[104] In the UK, concerns around the investment powers of charitable trusts led to new legislation in 2016 distinguishing between financial, social and programme related investments, as well as several iterations of guidance.[105]

58 For trustees of non-charitable, non-statutory trusts in New Zealand, the case law to date does not give us confidence that a court would, without clear direction in the trust deed or otherwise from the beneficiaries, protect a trustee from investment decisions based on their own views on climate change where those decisions would materially increase financial risk to the trust property.[106] We think this is especially the case given the broad use of the trust structure in New Zealand for managing household assets. Over time, of course, practical understandings of a trustees' duty to act in the best interests of beneficiaries may evolve further.

59 In this regard, the UK Law Commission conducted an extensive review of the legal position in 2014 and 2017, concluding, in line with the discussion above, that trustees may take into account non-financial factors only "*if they have a good reason to think that scheme members share a particular view and their decision does not risk significant financial detriment to the fund*".[107] The House of Lords has most recently endorsed these criteria in its 2020 decision in *R (Palestine Solidarity Campaign Ltd)*.[108] However, the Law Commission also indicated in the context of investment risk that "*[a]ssets which may individually be hazardous may be offset by safer investments to form a balanced portfolio*".[109]

60 These issues are very much now live. In April this year, the English High Court approved proceedings to be brought by trustees seeking guidance as to whether they could proceed with a climate change investment strategy that would risk financial detriment to the beneficiaries, potentially putting them in breach of their

[102] See the Community Trusts Act 1999, the Charitable Trusts Act 1957, the Charities Act 2005 and the Trusts Act 2019. Trustees of a charitable trust are permitted to invest trust monies in accordance with the requirements of the Trusts Act 2019 (s 21(2) Charitable Trusts Act 1957). The Community Trust Act 1999 requires that the trust deed specify the investment powers of trustees (s 15(g)) and also specifies that the Trusts Act 2019 applies to a community trust (s 21(1)).

[103] Community Trusts Act 1999, s 12(1).

[104] Trustees of charitable trusts in New Zealand are subject to the same general prudent investment requirements as other trustees, but may be able to decline investments where that would be inconsistent with the purposes of the trust: Butler, above n 4, at [11.15].

[105] See Charities (Protection and Social Investment) Act 2016 (UK); UK Charity Commision *Interim Guidance* (August 2016); UK Charity Commission's *Legal Underpinning for Charities and Investment Matters* (update March 2021).

[106] The UK Law Commission's subsequent 2017 report considered how pension fund trustees might ascertain the views of their members (ie the beneficiaries), stating that in some cases the trustees may be able to make assumptions as to their members' views, but where there was controversy, the courts would expect the trustees to focus on financial factors: UK Law Commission *Pension Funds and Social Investment* (22 June 2017) at [5.39 – 5.41].

[107] UK Law Commission *Fiduciary Duties of Investment Intermediaries* (30 June 2014), at [6.101]. The Law Commission repeated these criteria again in its 2017 report, above n 105, at [1.6] and [5.15].

[108] *R (Palestine Solidarity Campaign Ltd v SSCLG (SC(E))* [2020] 1 WLR per Lord Carnwath at [43].

[109] UK Law Commission, above n 106, at [6.101].

duties to act in the beneficiaries' best financial interests.[110] The fact that both are trustees of charities specifically established for environmental protection make the outcome of those pending proceedings of particular relevance for the issues in this opinion.

61 In summary, on New Zealand law as it stands today:

61.1 if the trustees can demonstrate that a particular climate-related investment has demonstrable potential financial benefits, or is likely to mitigate financial risk, including over the long-term, they will be able to justify its selection as aligning with the beneficiaries' best financial interests;

61.2 where the trust's purpose or objects clearly prioritise sustainability, or there is a clear mandate from all identifiable beneficiaries to do so (which in some cases could require an amendment to the trust), the trustees will likely be able to justify a particular climate-related investment, even where its financial performance might be lower than other investments; but

61.3 in all cases, the trustees must ask whether the investment is in the best interests of beneficiaries. This is (subject to specific trust deed terms) a judgement for trustees; in some cases, beneficiary consent to a particular investment strategy may still not be enough where this would risk significant financial detriment. For example, in *Re Vella* the Court ultimately adopted the option (as to which interest rate to apply) that fewer of the beneficiaries supported because it struck the correct balance between family and finances; and in *Re Corrigan* the Court noted the trustees' duty to ensure that appropriate investments were made for the benefit of the particular beneficiaries, despite the beneficiaries' support for investment into the community. But these decisions are inherently context dependent.

62 As a result, our view is that, while recognising a significant market shift to appreciation of ESG factors in investment decision making[111] and acknowledging the broader approach to investment reflected in caselaw and in the 2019 Trusts Act, trustees are still unlikely to be free to pursue climate-related investments on moral grounds that materially increase financial risk to trust property without a clear mandate to do so. In these cases, the New Zealand courts will continue to need justification that a low emissions or otherwise climate-related investment strategy implemented with potential to materially reduce financial performance is in the best interests of beneficiaries and is appropriate and prudent in the context of the trust deed and the overall investment strategy.

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[110] *Butler-Sloss & Ors v Charity Commission for England & Wales & Anor* [2021] EWHC 1104 (Ch).

[111] See eg Freshfields Bruckhaus Deringer *A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment* (2005); Responsible Investment Association Australasia *Impact Investor Insights 2019 Aotearoa New Zealand* (2019); UNEP Finance Initiative and Principles for Responsible Investment *Fiduciary Duty in the 21st Century Final Report* (2019).

Conclusion

63 Trustees' duties of prudent investment, to act for the benefit of beneficiaries, and of impartiality, all align when considering their ability and obligation to consider climate-related financial risk to trust investments. In light of the increasing understanding and awareness of climate-related risk in New Zealand in 2021, trustees will be expected to identify and assess climate-related financial risk to determine whether that risk is likely to be material.

64 While ever context-dependent, trustees should actively consider whether trust investments are at risk of material financial impact as a result of physical impacts or regulatory, market or legal developments connected to climate change. If so, then those trustees should appropriately manage that risk over the mid to long term, including by diversification and/or divestment of certain investments if appropriate. These assessments are not easy, but they are important for trustees to work through to properly discharge their duties to present and future beneficiaries.

29 July 2021

Nicola Swan
(Partner, Chapman Tripp)
T: +64 4 498 6389 M: +64 27 308 6000
E: nicola.swan@chapmantripp.com

Daniel Kalderimis
(Barrister, Thorndon and Richmond Chambers)
M: +64 27 599 5839
E: daniel.kalderimis@chambers.co.nz

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AUCKLAND

Level 34, PwC Tower
15 Customs Street West
PO Box 2206, Auckland 1140
New Zealand

T: +64 9 357 9000

WELLINGTON

Level 17
10 Customhouse Quay
PO Box 993, Wellington 6140
New Zealand

T: +64 4 499 5999

CHRISTCHURCH

Level 5
60 Cashel Street
PO Box 2510, Christchurch 8140
New Zealand

T: +64 3 353 4130

chapmantripp.com