Investing in a New World - ESG Considerations for Settlors and Trustees of Cayman Trusts

Service area / Trusts and Private Wealth
Legal jurisdiction / Cayman Islands
Date / October 2023

As the global marketplace continues to evolve, many investors have shifted their focus from purely profit-driven investments to those which are sustainable and have a positive impact on the environment, a process often referred to as Environmental Social and Governance investing (or ESG investing).

Examples of ESG investments include investments in businesses such as wind farms and solar power initiatives, or in companies that meet the investor's ESG value criteria (for example, because they have in place policies to address climate change or to ensure ethical supply chain sourcing). This shift in focus has no doubt been primarily driven by those who wish to support and enhance positive global initiatives, but another driver may also be the increased public attention on how and in what ways ultra-wealthy individuals are investing. Add in a new generation of beneficiaries who wish to become more involved in family structures, and to ensure the family's social conscious is clear, and ESG considerations become all the more important to take into account when considering investment opportunities on behalf of private clients.

With change such as this in the air, it is no surprise that trustees of Cayman Islands (**Cayman**) trusts are increasingly being asked to take into account ESG considerations in the course of their trusteeships. Fortunately, as explained further below, the jurisdiction is well-placed to facilitate ESG investing.

Practical considerations for trustees

Trustees are generally very eager to work with settlors and beneficiaries in order to make investments in line with a family's wealth management objectives. However, whether that is possible in practice will very much depend on the terms of the particular trust and any duties owed by the trustees. As a general rule, a trustee will usually have a duty to preserve and enhance the trust fund which may make it difficult to make an investment, even one which has a positive impact in the world, if there is a good chance that investment will lose money. In addition to that overriding requirement, certain types of investments may be expressly prohibited, such as speculative or illiquid investments (which are often features of ESG investments). Trust deeds may also stipulate that investments must be income producing, which may rule out some ESG investments. Trustees of older trusts may also need to consider the limitations imposed by perpetuity periods if they wish to make ESG investments with a long time horizon: practical difficulties may arise if an investment effectively ties up a large amount of capital for the remainder of the trust's life.

With all of this in mind, trustees need to carefully review the terms of the trust to ensure that any proposed investments are permitted – for older trust deeds, whether an investment is permitted or not may not be obvious. Assuming ESG investments are permitted by the terms of the trust, a trustee must also consider the risks of personal liability when deciding to make an ESG investment (as it should with all investments). While there may be a desire by the family to make sustainable investments, these may come at a cost when viewed against another possible investment which might not be as environmentally friendly but which is ultimately more profitable. That can leave a trustee exposed to potential claims from beneficiaries who do not support an ethos of ESG investing, who may say that the trustee should have chosen a different investment which would have generated a better return and that the trustee should be personally liable as a consequence.

Suitable structures and trustee protections

When establishing new trusts for the purposes of ESG investing, priority should be given to ensuring that the trust deed is tailored to provide for flexibility in investing. To address the risks to a trustee briefly mentioned above, there are a number of options available in Cayman that are worth considering:

STAR trusts

A Cayman STAR trust, with the ability to have beneficiaries or purposes (or both), is an ideal vehicle for ESG investments. By having a trust with the specific purpose of making ESG investments within certain defined parameters, the trustee can make investments without fear of criticism provided that the investments are within the bounds of what is permitted. A STAR trust must have an enforcer (to ensure the trustee gives effect to the terms of a trust) which can be the settlor or a corporate entity controlled by family members allowing the family to retain an element of control and direction over the structure.

Reserved powers trusts

As an alternative to a STAR trust, a trust could be formed with powers reserved to a third party (such as the settlor or protector) to direct the trustee as to its investment decisions. In this way, the trustee could be directed to effect an investment by the reserved power holder such as an investment committee and in doing so would be relieved from any liability associated with following that direction pursuant to section 15 of the Trusts Act (as revised) (the **Trusts Act**). This may be a more cost effective option in terms of the establishment of the trust and its ongoing administration as compared with a STAR trust, particularly if the enforcer is an independent service provider (rather than the settlor or family members).

Private Trust Companies or PTCs

A further option may be to form a private trust company (**PTC**) to act as trustee of the trust, where the board of the PTC could be made up of family members allowing the control of the trust and its ESG investing strategy to remain with the family. This option may be more costly to establish (particularly if the shares in the PTC are to be owned by a STAR trust which is often the case in order to orphan the structure and thereby creating an additional layer of cost) but may end up being cheaper to administer depending on whether the Cayman licensed fiduciary[1] provides any directors of the PTC.

Bespoke investment provisions

As a simple way of allowing for ESG investments to be made, specific provisions can be incorporated into the trust deed which record that the trustee has a wide investment power, including an express power to make ESG investments. These provisions could define what will constitute an ESG investment and impose any applicable limits or requirements so that the trustee knows exactly where it stands. Bespoke ESG investing provisions would usually be inserted from the outset, however it may be possible (if there is a power to vary the terms of the trust) to vary an existing trust to include a new provision which caters for ESG investing. From a trustee liability perspective, this is not as effective as a reserved investment power mechanism as the liability for any losses associated with a particular ESG investment will still sit with the trustee. However, it should at least prevent an argument around whether an investment was permitted by the terms of the trust.

Indemnities and releases

Where there is a desire to use an existing trust to make ESG investments and the trust deed does not contain any specific mechanisms such as reserved powers or bespoke investment provisions, it may be necessary for the trustee to seek releases from beneficiaries in respect of any claims that they might be able to bring in connection with an ESG investment. In addition, indemnities could be obtained from beneficiaries to protect the trustee from liability associated with an ESG investment. Whilst these can be good protections for a trustee, they may not assist where the beneficial class of the trust includes minor and unborn beneficiaries who cannot provide releases. Indemnities may also not be without issues as the beneficiary who gave the indemnity may no longer have the resources to meet claims under it or they may simply refuse to pay, requiring costly enforcement action to be taken by the trustee.

1 All Cayman PTCs must have their registered office maintained by a licensed fiduciary.

Continued

Court intervention

In certain circumstances, it may be necessary to involve the Grand Court of the Cayman Islands (the **Court**) in connection with proposed ESG investments. For example, if the particular investment is considered 'momentous' in the context of the value of the trust, it may be prudent for the trustee to seek the Court's blessing under the *Public Trustee v Cooper*[2] jurisdiction to protect the trustee from later claims by beneficiaries. Alternatively, where the trust deed is not clear as to whether the trustee has the power to make a particular ESG investment, it may be necessary to apply to the Court for directions and a declaration that it holds the power to invest as proposed. As another option, if the trust deed does not contain an investment provision wide enough to make ESG investments and there is no power of variation to include such a power, it may be possible to apply to the Court to vary the terms of the trust under section 72 of the Trusts Act[3]. For each example of Court intervention, the decision as to whether an application to Court is needed will depend very much on the value of the trust and the size of the proposed investment, both of which are relevant to the trustee's potential exposure.

Conclusion

ESG investing is much more than a passing fad, and is anticipated to increasingly become a primary investment goal of many private clients (who, thanks to the spread of global wealth, now comprise a diverse range of investors across a variety of age groups). As global citizens ask more of companies to explicitly address their own environmental impact, the safety and usefulness of their businesses and products, and the health and safety of their workers, investors and their managers will also become more focussed on monitoring and assessing ESG compliance. Utilising structures and procedures that offer flexibility, purpose, and control over these forms of investment is an integral part of this process, and the Cayman Islands is clearly well-placed to assist.

2 [2001] W.T.L.R 901
3 Something made easier by the recent change to the Trusts Act, amending the threshold for the Court to approve a variation from it being a 'benefit' to the beneficiaries to it not being 'to their detriment'.

FIND US

Carey Olsen
PO Box 10008
Willow House
Cricket Square
Grand Cayman KY1-1001
Cayman Islands

T +1 345 749 2000
E cayman@careyolsen.com

FOLLOW US

Visit our trusts and private wealth team at careyolsen.com

PLEASE NOTE

'Carey Olsen' in the Cayman Islands is the business name of Carey Olsen Cayman Limited, a body corporate recognised under the Legal Practitioners (Incorporated Practice) Regulations (as revised). The use of the title 'Partner' is merely to denote seniority. Services are provided on the basis of our current terms of business, which can be viewed at www.careyolsen.com/sites/default/files/TermsofBusiness.pdf

CO Services Cayman Limited is regulated by the Cayman Islands Monetary Authority as the holder of a corporate services licence (No. 624643) under the Companies Management Law (as revised).

This briefing is only intended to provide a very general overview of the matters to which it relates. It is not intended as legal advice and should not be relied on as such. © Carey Olsen 2023.