COLLAS CRILL

Investing for good: What is "impact" investing?

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What is "impact" investing, sometimes referred to as responsible or sustainable finance, and what do trustees, family offices and others in the private client space need to know about it?

We are all becoming increasingly socially-conscious and aware of the challenges facing a changing world, be it environmental or conservation issues through to refugee crises or the need for social housing. It is not a surprise, therefore, that the possibility of investing in a way that could have a positive impact on the world while still generating a return on that investment is an attractive thing. Doing good and seeing a return – it's a win-win, right?

Essentially, impact investing is an investment process where the intention is to have a measurable positive social or environmental impact whilst generating financial returns. This isn't a fanciful pipe dream either; assets under management in this class were reported as US$ 500 billion in 2019 with the numbers predicted to continue to rise over years to come. Many impact investments are also beating the broader market in performance disproving the traditional perception that there must be a trade of between doing good and doing well.

You may well have clients that are keenly involved in specific philanthropic or "impact" issues already. Others may simply express a general desire to put some of their wealth into supporting good causes. Either way, it is prudent for trustees and other advisers to be alive to the potential benefits and challenges of this area to be able to meet their clients' needs fully.

For those tasked with investing "ethically" or "putting a clients money to good use" one traditional option was to simply request an investment manager to carefully construct a portfolio that negatively screened out potential "sin stocks" (e.g. tobacco, pornography, gambling, oil/traditional energy). A second route was to devote a portion of a client's funds to pure philanthropy. However, there now exists a number of options in between.

The opportunities to invest can range from a private equity holding with an extremely specific impact focus to funds investing in a spectrum of impact areas, green, climate and social impact bonds as well as other offerings. The impact focus might involve environment and conservation, education, renewable energy, job creation, health or housing, amongst various others. There is potentially something to suit everyone in terms of focus and risk appetite.

Impact investors have diverse financial return expectations. For those investors prioritising the social or environmental outcome of their investment, they often are willing to accept below market rate returns. Others

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may pursue market competitive returns but are seeking investments that will also deliver a social or environmental return.

Where clients favour giving the impact focus precedence over the financial returns, however, this can be a difficult area for trustees in particular to navigate. There remains the duty to act in the best interests of the beneficiaries which, arguably, could be read narrowly as ensuring a decent return on funds invested. Just because the settlor of a discretionary family trust felt strongly about education for children in Kenya, does not mean potentially litigious future generations or the wider beneficial class will be sympathetic to losses (or lower than average growth) within the trust fund.

To mitigate this we suggest two approaches should be considered by trustees and family offices:

1. Embed an impact purpose into the structure –

We suggest that embedding the ethical aim or purpose of the structure/vehicle into the governing documents themselves could have a number of benefits:

(i) the scope and requirements are clear and allow the trustees to act more confidently in pursuance of the aims or purpose;

(ii) provides reassurance for the client and/or family. The governing documents themselves can create binding obligations on or express considerations for the trustees to follow (as opposed to a non-binding letter of wishes, for example) – potentially creating an enforceable right where a beloved impact goal may otherwise be ignored; and

(iii) potentially mitigates risk for the trustee – when investing in a relatively unknown or specific area, where returns may not be guaranteed or predictable, having the purpose built into the structure documentation from the outset gives the trustee both clear guidance as to what to work with and towards and assists to manage the beneficiaries' and other interested parties' expectations and understanding. As noted above, the risk of criticism (or worse, litigation) from future generations or members of the wider class of beneficiaries may be reduced if there is a clear understanding at the outset of what the vehicle was to be used for and its aims.

There are a variety of types of structure that could participate in impact investing, where impact purpose could be drawn into the governing documents themselves. To give a few examples:

a) A purpose trust – a stand alone purpose trust could be established, the purpose of which could be intentionally broad but sufficiently certain, such as: "to invest in green or impact causes" or much more specific, such as: "for the advancement of Marine Conservation Zones in the UK". The advantage of a broad purpose would be to give the trustee flexibility and a larger range of options for investing. The downside might be that it gives little guidance to the trustee as to what the client or family wish to achieve and potentially the trustee's decisions are more exposed to future question or criticism.

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b) A discretionary or life interest trust with a built in purpose – this would be a discretionary or life interest trust in the sense that you have a named or an identifiable class of beneficiaries (rather than solely a purpose). The difference is that there would be express provisions in the trust instrument itself setting out the intentions for the trust. As above, this could be broadly stated or quite specific depending upon requirements and circumstances. This hybrid structure was always popular under the Cayman "STAR" regime and clients are often surprised to learn that Guernsey's trust law envisages the same type of structure.

c) Private Trust Company (PTC) – where a family have a pre-existing PTC or are looking to establish one, it could be possible to have one specific underlying discretionary trust the aim of which were to ring-fence a "pot" for impact investing. Again, the aims/purposes could be drawn into the discretionary trust instrument itself. This would also allow the family to have some participation in the management of the structure where, for example, family members sit on the board of the PTC.

d) Foundation – This is a fairly obvious one, as foundations have traditionally been used for charitable or philanthropic purposes. A Guernsey foundation can be either purely for a purpose or for the benefit of individual beneficiaries (the latter alongside a purpose). It can be established for a wide array of purposes, so the foundation's Charter can therefore be fairly broad or very specific in setting out its purpose. The Rules can also expressly specify how the assets of the foundation should be applied.

2. Bring in the experts:

In an area where trustees may have a knowledge or experience gap (for understandable reasons), it is critical to identify and work with an expert in the field who can talk to the trustee and the client, support the design of a strategy, carry out research, provide case studies and report back on options for achieving the intended impacts. Just as fiduciaries monitor and report financial performance it also essential to track and report the intended social and/or environment outcomes of investments against an agreed impact measurement framework.

An example would be local firm Innovest Advisory, who serve as a dedicated social impact advisor to both impact investment funds and the private wealth sector and who already work with a number of Channel Island fiduciaries and family offices in addition to private wealth clients in other jurisdictions. Innovest founder Justin Sykes noted that their specialist international development expertise enables them to provide the bespoke skills and tools needed to develop meaningful solutions that resonate with the impact aspirations of private wealth clients, and then effectively monitor and prove that target outcomes are being achieved.

By engaging with experts, the trustee gains the reassurance of relying on their technical expertise to design social and/or environmental impact strategies from the outset giving comfort they truly are meeting their client's wishes as opposed to paying them lip service.

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> 'Having a clearly identified and agreed impact strategy together with robust impact measurement provides the rigour trustees desire when exercising their fiduciary role.

There is one thing we are sure of: the movement towards a more environmentally and socially conscious world is not going away. We see impact investing as having long-term potential. Private client advisers and trustees having greater awareness of it and garnering experience in the field is as good for them and their clients as it is for the causes that they support.

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