Has the scope for ESG investments by pension schemes widened?

Butler-Sloss and others v Charity Commission for England and Wales

Introduction

A recent case has been handed down where the court has permitted the trustees of two charities to adopt an ESG-based investment strategy. This is notwithstanding that the trustees acknowledged that the investment strategy would provide a lower rate of return in the short-term when compared with other, less restrictive, investment strategies.

Does this therefore suggest that the scope for ESG investments by pension scheme trustees might have been extended?

Background

The trustees in question were trustees of two charities concerned with environmental protection and the relief of poverty. The trustees asked the court whether they could adopt an investment policy that excluded certain investments which the trustees considered conflicted with the charitable purposes. The proposed investment policy would allow the trustees to choose investments based on whether they were aligned with the Paris Climate Agreement.

It was accepted that the proposed investment policy, when compared to a broader investment policy, would have resulted in financial detriment in the short-term. It was, however, hoped there would not be a material financial impact in the long-term.

The decision

There was a question mark as to whether caselaw prohibited charity trustees from investing in a way that was directly in conflict with the charity's purposes.

The court held that there was no absolute prohibition on making investments which directly conflict with a charity's purpose. The trustees' primary duty is to further the purpose of the charity, which will usually involve producing the best financial return for the benefit of the charity and its purposes. Where the trustees consider investments potentially conflict with the charitable purpose, they have a discretion whether to exclude such investments. In exercising this discretion they must balance all relevant factors, including the extent of any potential conflict when weighed against the risk of financial detriment. Financial detriment can include the risk of losing support from donors and damage to the reputation of the charity.

Ultimately, the court blessed the proposed investment strategy.

How does this impact pension scheme trustees?

Whilst, at first sight, it appears that trustees may now be able to choose investment strategies based on ESG considerations even where the result is financially detrimental, the case of *Butler-Sloss* is concerned with **charitable trusts** and not pension scheme trusts. Trustees of both types of arrangements are subject to fiduciary investment duties but there are clear distinctions to be drawn. Charities do not have beneficiaries in the same way that pension schemes do. In addition, the purpose of a charity is to further its cause, for example that of environmental protection. In the case of a pension scheme, its purpose is to provide pensions and benefits for members and beneficiaries.

There has long been confusion amongst pension scheme trustees about the extent to which non-financial ESG factors can be taken into account. We discuss these issues more in our briefing on the topic but, in short, it seems that we are a considerable way off a decision where an ESG investment strategy which causes financial detriment would be appropriate in the pensions context.

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