Article

# CC14 guidance update: greener investments, greater uncertainty?

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## Abstract

This article examines the newly released Charity Commission guidance, known simply as the "CC14". The CC14 provides investment guidance to the charity sector and has recently been renewed following the case of *Butler-Sloss & Ors v The Charity Commission for England and Wales & Anor* [2022] EWHC 974 (Ch). In *Butler-Sloss*, the High Court was asked to determine whether charitable trustees could deploy an investment plan that aligned with the Paris Agreement and excluded investments that contributed to climate change. Mr Michael Green J ruled that such an "ethical" investment plan was lawful. Following *Butler-Sloss*, the CC14's use of "social investment" may indeed encourage "greener" investment opportunities amongst charitable trustees, in that the advice attempts to bring charitable trustee investment more in line with modern investment practices. However, this work opines that the guidance could be actively encouraging environmentally inspired investments at the expense of the sacrosanct fiduciary duty of investment.


## Introduction

This article examines the updated Charity Commission guidance, known as "CC14", which outlines the trustees' fiduciary duty of investment.[1] The CC14 was released on 1 August 2023 to restore clarity following the High Court's decision in *Butler-Sloss & Ors v The Charity Commission for England and Wales & Anor* [2022] EWHC 974 (Ch) (hereafter "*Butler-Sloss*").[2] Together with the main document, the CC14 is also made up of a legal underpinning document.[3]

This work is concerned with the CC14's use of "social investment" (SI), and whether this may encourage "greener" investment decisions by trustees. While the CC14 is "soft" law and has no private law effect, it is nevertheless a significant source because it outlines the Commission's approach to trustee investment, which is followed *en masse* by the charity sector.

The relationship between charity investment and environmental issues may be seen as nebulous, yet a connection exists. The CC14's analysis of the state of the law shows that trustee investment practice can promote environmental and social outcomes. The meaning of the "environment" in this context is broad since it is linked to charitable purposes, which are unique to each charity and are therefore multifarious. In *Butler-Sloss*, for instance, the trusts' purposes included environmental protection or improvement and the relief of poverty.[4] There, the trustees sought to deploy an investment plan that aligned with the Paris Agreement adopted at

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1. Charity Commission for England and Wales, 'Investing charity money: a guide for trustees' (*gov.uk*, 1 August 2023) <https://www.gov.uk/government/publications/charities-and-investment-matters-a-guide-for-trustees-cc14/charities-and-investment-matters-a-guide-for-trustees> accessed 22 August 2023.
2. *Butler-Sloss & Ors v The Charity Commission for England and Wales & Anor* [2022] EWHC 974 (Ch), [2022] Ch 371.
3. Charity Commission for England and Wales, 'Charities and investment matters: Legal underpinning' (*gov.uk*, 1 August 2023) <https://www.gov.uk/government/publications/charities-and-investment-matters-a-guide-for-trustees-cc14/charities-and-investment-matters-legal-underpinning> accessed 29 August 2023.
4. ibid [1].

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COP21, which binds states but not individuals.[5] The trustees wished to exclude "investments that were considered to be contributing to climate change, such as fossil fuels".[6] However, the judgment states that the trustees "favoured companies with policies or products designed to limit climate change".[7]

As well as SI, the CC14 encourages environmental outcomes by including "environmental, social, and governance" (ESG) factors[8] as a "financial investment approach".[9] ESG factors are listed as "climate, human rights, sustainability, community impact and board accountability".[10] ESG is designed to stem the flow of finance to companies and projects that create negative ESG impacts, whilst increasing finance to things that have positive ESG ratings.[11]

Thus, the importance of charitable investment to the environment lies in the plethora of issues and causes that may be impacted, either through SI or financial investment approaches. Nevertheless, it is argued here that while the CC14 may allow for a greater number of "environmentally inspired" investments, this comes at the price of sectoral investment uncertainty.

## The duty to invest

Trustees possess, *ex officio*, a fiduciary investment duty that has been codified by statute and expanded upon in the case law.[12] The purpose of this section is to provide an outline of this duty, for context, prior to analysing *Butler-Sloss* and the CC14 in the next section.

### *Trustee act 2000*

The investment duty is contained in the Trustee Act 2000.[13] Trustees are bound by the statutory duty of care found in section 1, and they should "use such skill and care as is reasonable in the circumstances".[14]

Pursuant to section 3, trustees are granted a "general power of investment".[15] This permits a trustee to "make any kind of investment that he could make if he were absolutely entitled to the assets of the trust".[16] The general power can be limited by the trust instrument or the consent of all *sui iuris* beneficiaries.[17] It is also noteworthy that section 3 does not apply to "charitable trustees who are managing common investment or common deposit schemes".[18]

Section 4 sets out the *standard investment criteria* (SIC).[19] The SIC enforces a duty on trustees to review the "suitability" of their investments and evaluate whether any extant investments should be varied.[20] The investment plan should achieve a "diversification of investments of the trust".[21] Interestingly, a "portfolio" approach to investment should be adopted.[22] In recent years, investors have tried to improve their performance by including a combination of conventional and non-conventional investments in their portfolios.[23]

5. ibid [6]; United Nations, 'The Paris Agreement' (*unfccc.int*, no date) <https://unfccc.int/process-and-meetings/the-paris-agreement> accessed 29 August 2023.
6. ibid [18].
7. ibid.
8. CC14 (n 1).
9. ibid.
10. ibid.
11. United Nations, 'Who Cares Wins: connecting financial markets to a changing world' (December 2004, United Nations Global Contact) <https://documents1.worldbank.org/curated/en/280911488968799581/pdf/113237-WP-WhoCaresWins-2004.pdf> accessed 29 August 2023.
12. Graham Virgo, *The Principles of Equity & Trusts* (4th edn, OUP 2020) 399–400.
13. Trustee Act 2000.
14. ibid, s 1. NB: There is also a common law duty of care, but the statutory duty applies to investments.
15. ibid, s 3.
16. ibid.
17. 'The ethical trustee' (*Step Journal*, 1 September 2010) <https://www.step.org/step-journal/step-journal-september-2010/ethical-trustee> accessed 29 August 2023.
18. Virgo (n 12), 407.
19. Trustee Act 2000, s 4.
20. ibid, s 4(3)(a).
21. ibid, s 4(3)(b).
22. Rosy Thornton, 'Ethical investments: a case of disjointed thinking' (2008) 67(2) *The Cambridge Law Journal* 396, 399–400.
23. ibid.

Prior to making an investment or reviewing investments, the "proper advice" should be obtained and considered but need not be followed.[24] Trustees can exclude section 5 if they reasonably conclude that the proper advice is unnecessary.[25]

## *The "fiduciary" investment duty*

Virgo explains that "The essence of a fiduciary relationship is that the fiduciary has undertaken to act for or on behalf of somebody else in circumstances that give rise to a relationship of trust and confidence."[26] He goes on to suggest that "The key obligation of a fiduciary is one of loyalty, in that the principal is entitled to the single-minded loyalty of the fiduciary."[27] The duty of loyalty is made up of the "no-conflict" and "no-profit" rules,[28] that is trustees must not put themselves in a position of conflict, nor profit from their trusteeship.[29]

*Cowan v Scargill* [1985] Ch 270 concerned a schism that had emerged between the National Coal Board's pension trustees.[30] The general investment plan sought to cease and withdraw from overseas investment and desired to withdraw from investments that competed with coal.[31] As to how trustees should exercise their investment power, Sir Robert Megarry VC ruled that 'the best interests of the beneficiaries are normally their best financial interests.'[32] To act with the requisite "loyalty" meant taking a financially driven, value-based approach. *Cowan* demonstrates that morality should largely be set to one side.[33]

A further chance to assess the investment power came in *Harries v The Church Commissioners of England* [1992] 1 WLR 1241.[34] This case concerned a charity trust, *viz.* the trust funds of the Church of England.[35] The plaintiffs expressed disquiet at the Church Commissioners' investment plan, believing that it paid undue attention to financial profits.[36] The plaintiffs argued that ethical considerations should guide the investment plan, and investments incompatible with the trusts' purposes should not be exercised, even if financial detriment was incurred.[37]

In *Harries*, Sir Donald Nicholls VC thought that the declaratory relief was ambiguous, being based on moral questions "to which there can be no certain answer".[38] He believed that the Church Commissioners had applied the appropriate level of ethical consideration; after all, their policy statement did not permit investments in 'companies whose main business is in armaments, gambling, alcohol, tobacco or newspapers'.[39]

The VC distinguished between charitable property used for a "functional" purpose[40] and property used to generate money from income or capital growth.[41] For the latter, the *prima facie* starting point is "best served by the trustees seeking to obtain therefrom the maximum return".[42] But this may be excluded where the investment directly conflicts with charitable objects[43] or hampers the

24. Trustee Act 2000, s 5.
25. ibid, s 5(3).
26. Virgo (n 12), 445
27. ibid 446
28. ibid.
29. *Lord Vestey's Executors v* IRC [1949] 1 All ER 1108, 1115.
30. *Cowan v Scargill* [1985] Ch 270, 276.
31. ibid, 276–277.
32. ibid, 287.
33. Virgo (n 12), 412. See also, *Martin v City of Edinburgh DC* [1989] PLR 10; cf Thornton (n 22), 410.
34. *Harries and Others v The Church Commissioners of England and Another* [1992] 1 WLR 1241.
35. ibid, 1243.
36. ibid.
37. ibid.
38. ibid, 1251.
39. ibid, 1250.
40. ibid, 1246.
41. ibid.
42. ibid.
43. ibid.

charity's ability to retain and attract donors.[44] In the VC's mind, these cases are "comparatively rare".[45]

Nicholls VC believed that charity trustees could "accommodate the views of those who consider that on moral grounds a particular investment would be in conflict with the objects of the charity, so long as the trustees are satisfied that course would not involve a risk of significant financial detriment."[46]

## Butler-Sloss v the charity commission

An application was brought to the court by two charities for a "court blessing".[47] The question was whether the charities could adopt an investment policy that excluded investments which conflicted with their charitable objects.[48] The charities in question were the Ashden Trust and the Mark Leonard Trust.[49] Eighty-five per cent of both funds were managed by Cazenove and the other 15 per cent were managed by the claimants via an "impact investment", hence the joint appeal.[50]

The law is summarised at [78], which acknowledges that the trustees' overarching duty when investing is to further charitable purposes.[51] This is "normally achieved by maximising the financial returns on the investments",[52] and there is a need to comply with the Trustee Act 2000.[53] Further, the trust instrument can prohibit specific investments.[54]

Michael Green J found that SIs "are made using separate powers than the pure power of investment".[55] With discretion, trustees can exclude investments that "potentially conflict" with their purposes.[56] The judgment states that "they should exercise that discretion by reasonably balancing all relevant factors including, in particular, the likelihood and seriousness of the potential conflict... [and] any potential financial effect".[57] The second means to exclude is cited at [78](7): "trustees can take into account the risk of losing support from donors and damage to the reputation of the charity generally".[58]

The judgment warns that "trustees need to be careful in relation to making decisions as to investments on purely moral grounds", given the plethora of legitimate moral views that may exist.[59] Where there is the possibility of conflict or reputational damage, trustees should "exercise good judgment by balancing all relevant factors".[60] In *Butler-Sloss*, Michael Green J found that the claimants had "balanced [their] objective with any financial detriment that may be suffered as a result'[61] and, in consequence, ruled that they had 'exercised their powers properly and lawfully".[62]

## The CC14

The above reasoning outlined by Michael Green J in [78] is fully adopted in the guidance, as shown here:

> In many cases this will involve charity trustees investing in order to maximise the financial return to the charity, so that the resulting funds are available for the charity's purposes; but there will be some cases where

44. ibid, 1247.
45. ibid, 1246–1247.
46. ibid, 1247.
47. See, *Public Trustee v Cooper* [2001] WTLR 901.
48. *Butler-Sloss* (n 2), [1].
49. ibid, [12].
50. ibid, [17].
51. ibid, [78].
52. ibid.
53. ibid.
54. ibid.
55. ibid.
56. ibid.
57. ibid.
58. ibid.
59. ibid.
60. ibid.
61. ibid, [87].
62. ibid, [88].

> factors other than investment performance are also relevant to trustee decision-making. These include cases where potential investments may conflict with the purposes which the charity is established to achieve, or cases where making particular investments may risk damage to the reputation of the charity among donors, beneficiaries, or others.[63]

The CC14 further advises trustees that "you can also invest with a view to both achieving your charity's purposes directly through the investment and making a financial return. Charity law calls this social investment."[64] The 2023 guidance has updated its nomenclature, replacing the term "ethical" investment with the concept of "social" investment.[65] Further, the terms "programme-related investment" and "mixed-motive investment" are also no longer used.[66]

A "financial return" in relation to SI is where the charity is "better off from the investment than it would be if the funds or property were spent".[67] However, the CC14 notes that not all SIs are instigated to make significant profits, and an SI "can also be where your charity only expects to receive back some or all of the money you invested, with no capital growth or income".[68]

As per *Butler-Sloss*, if a charity adopts an SI approach, "the specific trustee duties that apply are different from those that apply to financial investment".[69] SI allows charity trustees to decide on their investment aim, being based on a financial return or achieving the charity's purposes.[70] However, even with SI, the Trustee Act 2000 statutory duties remain.[71]

A non-exhaustive list of approaches has been created to assist trustees in deciding on investment strategies.[72] On this basis, investment approaches vary from only aiming for the best financial return, to indirectly assessing reputation risk.[73] For instance, a possible approach could consider ESG factors, so long as it protects or enhances financial value or supports charitable objects.[74]

## Greener investment opportunities?

While the refreshed guidance could lead to greener and more environmentally inspired investments, it is shown here that there are several issues with the updates that should make reasonable charity trustees proceed with caution. Worryingly, the recent developments may allow for greater SI adoption that acts contrary to the fiduciary duty outlined above.

### *Nomenclature changes*

The guidance has made clear that the old term "ethical investment" should now be replaced with "SI".[75] If one is to consider the latter term to be broader than the former, then this may lead to investment portfolios being permitted to consider a greater range of "greener" opportunities. That said, there is some uncertainty surrounding the definition of SI that should be noted. This section argues that the Commission's attempt to broaden the range of environmental and social opportunities could lead to conceptual uncertainty and impact the fiduciary investment duty owed.

Martini suggests that "Currently, there is no generally agreed-upon definition on what SRI actually is. Indeed, many authors have documented that the definition is

63. Legal underpinning (n 3).
64. CC14 (n 1).
65. ibid.
66. ibid.
67. ibid.
68. ibid.
69. ibid.
70. ibid.
71. Legal underpinning (n 3).
72. CC14 (n 1).
73. ibid.
74. ibid.
75. ibid.

not univocal."[76] Richardson suggests that SI "is a beguilingly simple yet conceptually elusive term, definable in a myriad of ways".[77] He defines the term "descriptively, to refer to various forms of investing and financing that purport to taken into account social, environmental and other non-financial criteria; and normatively, about what RI *ought* to be".[78] The issue with the CC14 is that it describes the SI concept, but does not effectively demonstrate what it ought to be in practice. This could lead to practical issues as different approaches are adopted.

The literature shows that SI may not mean the same thing as "ethical" investment, which has previously been used by the courts in, *inter alia*, *Cowan* and *Harries*. Some authors consider ethical investment and SI to be different labels for the same concept. For instance, Hellsten and Mallin use the terms interchangeably in their article, noting the semantic difference to be geographical only.[79] Conversely, Martini writes that ethical investment began as "a niche, mainly as a religious-led exclusionary practice, towards a mainstream strategy of risk analysis for institutional and retail investors".[80] She suggests that ethical investment and "socially responsible investment" (SRI) can be seen "as a subset of the broader concept of "Social investment' or 'Social finance'."[81] It does not seem that ethical investment and SI are considered the same by the Commission, and appears that the terminological change was done to extend the concept following the decision in *Butler-Sloss*.

The court's rulings before *Butler-Sloss* concerned ethical investments based on the application of Kantian, moral imperatives. On the other hand, the CC14 shows that SI can now include a range of scenarios: for example moral imperatives, ethical goods, ESG risk analyses and breaking even on investments that appease charitable purposes.[82] The latter is particularly problematic as could contradict the fiduciary duty of maximising financial profits. Further, the expansion of this concept may now signal that the Charity Commission will be less willing in future to challenge SI policies.

### *Conflicts of interest*

There are also practical problems with the CC14, in that it does not adequately deal with the issue of conflict. The guidance's "balancing exercise" is likely to render possible solutions multifarious and difficult to reconcile with the conceptual uncertainty surrounding SI.

An issue with [78] of *Butler-Sloss* is that it created uncertainty as to whether Michael Green J had instigated "a binding principle of law as to the degree of importance of avoiding a direct conflict in every case".[83] The CC14's legal document clarifies that this was not the court's intention.[84] Instead, Michael Green J was interested in "providing general guidance which should be read alongside the summary and statements of principle at [78] of the judgment".[85] In the Commission's analysis, the judge was simply suggesting "that trustees need to have regard to all relevant factors, including potential direct conflicts between investments and objects, and exercise their discretion appropriately".[86]

It is good that the CC14 has clarified the above issue. However, *Butler-Sloss* was a case with a highly specific set of facts and its principles have now been adopted as general guidance. The Commission believes that *Butler-Sloss* has a wider application, but the extent of its reach remains to be further tested. The court and Commission have warned trustees about making

76. Alice Martini, 'Socially responsible investing: from the ethical origins to the sustainable development framework of the European Union' (2020) 23 *Environment, Development and Sustainability* 16874, 16876.
77. Benjamin J. Richardson, *Fiduciary Law and Responsible Investing: In Nature's Trust* (Routledge 2013) 1.
78. ibid.
79. Sirkku Hellsten and Chris Mallin, 'Are "Ethical" or "Socially Responsible" investments socially responsible?' (2006) 66(4) *Journal of Business Ethics* 393.
80. Martini (n 76), 16874.
81. Ibid, 16876.
82. CC14 (n 1).
83. Legal underpinning (n 3).
84. ibid.
85. ibid.
86. ibid.

decisions based purely on moral grounds and yet acknowledge that a range of different, legitimate moral views can arise. With the CC14, there now exists a greater possibility of, for example, donor pushback on investment decisions and "quiet moral investment",[87] but no certain steer on how to deal with these issues. Therefore, the guidance should be criticised as an attempt to impose apparent universal rules to distinct situations of morality.

### *Attitude to risk*

The CC14 attempts to develop charity trustees' "attitude to risk" by showing that investments carry both conventional and non-conventional risks.[88] The CC14's assessment of the trustees' fiduciary duty accords with some of the literature on risk appraisal in modern investment approaches. Indeed, a contemporary viewpoint is that accounting for ESG factors may improve the overall financial performance of investment portfolios, as follows:

> . . . growing empirical evidence has shown that ESG-related issues represent concrete sources of potential risk for investors, so that incorporating ESG criteria in investment strategies should become part of an overall risk analysis aimed at contributing to more stable financial returns.[89]

In the United Nations Environment Programme's Finance Initiative (UNEP FI), otherwise known as the "Freshfields report", ESG should not be viewed as "non-financial" but criteria that are value driven and which can be used to provide "an investment analysis so as to more reliably predict financial performance".[90] And the beneficial use of ESG in this way was found in all jurisdictions observed by Freshfields.[91] It is noteworthy that the Freshfields report was concerned with institutional investors, but its findings are nonetheless relevant for the impact that SI and ESG can have on the charity sector.

The report examined the extent to which the fiduciary duty is impacted by ESG.[92] Interestingly, it found that the duty does not interfere with the ability of fiduciaries to integrate ESG.[93] In fact, the report goes further to suggest that it is fiction to say that the fiduciary concept is primarily concerned with maximising profits.[94] The Freshfields report viewed *Cowan* as a "misunderstood case".[95] Freshfields recommended that the case should not be used to "support the single-minded pursuit of profit maximisation, or indeed any general rule governing decision-making: it is a narrow case that turns on its own special facts".[96] It goes on to comment that "In any event, the case's practical relevance today is questionable. Fiduciary duties evolve over time according to changes in social norms and the values of society and, to a degree, technological and market changes."[97] Thus, there is support for *Butler-Sloss* and the CC14. However, Sandberg wrote that in light of the Freshfield report, further legal reform is required to provide a better perspective for the future directions of this area; however, he does not proffer his viewpoint on the reforms that should be instigated.[98]

Despite the above, it is essential that the modern approach to investment does not obscure the main goal of trusts: attaining overall financial returns. In separating

87. Luke Broadway, '*Butler-Sloss v The Charity Commission*: ESG investment guidance in need of elaboration' (2022) 28(9) *Trusts & Trustees* 849, 859.
88. CC14 (n 1).
89. Martini (n 76), 16875.
90. Freshfields Bruckhaus Deringer, 'A legal framework for the integration of environmental, social and governance issues into institutional investment' (UNEP Finance Initiative, October 2005), 13 <https://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf> accessed 29 August 2023.
91. ibid.
92. ibid.
93. ibid.
94. ibid, 27.
95. ibid, 9.
96. ibid.
97. ibid.
98. Joakim Sandberg, 'Socially responsible investment and fiduciary duty: putting the Freshfields report into perspective' (2011) 101(1) *Journal of Business Ethics* 143, 146.

out trustee duties for SI pursuant to section 292C Charities Act 2011,[99] the guidance outlines what is required from the statutory framework. But understanding the difference between the "pure investment power" and "SI" could be a potential source of confusion for trustees.[100] Certainly, pure investment power can just as easily lead to positive environmental outcomes, for example by directly investing in sustainable energy.

Moreover, identifying SI is difficult. The legal document states that "Whether or not a social investment is being made is determined by the motivation of the charity".[101] It goes on to opine that "The definition is wide and may include some actions which would not ordinarily be thought of as investments."[102] This advice is far too objective and uncertain, and there is a concern that donors and beneficiaries could be significantly impacted if an investment plan is designed to take account of environmental and social factors *in lieu* of financial returns.

There is also a balancing act with charity trustees that Broadway describes as an "institutional paradox".[103] He says that "One may reasonably ask what a charitable trustee should prioritise, meeting their objectives through investment, or meeting their objectives through (for example) the application of trust property to donees?"[104] Broadway criticised the court in *Butler-Sloss* on the ground that it did not establish a degree of risk.[105] It is his opinion that "There is therefore an absence of guidance on what constitutes a justifiable sacrifice of income returns under an ESG investment policy."[106] Even after the release of CC14, it is clear that there is still a gap in our knowledge of the degree of risk to be enforced when making SIs.

## Conclusion

This article has looked at the CC14 changes, instigated following the 2022 High Court decision in *Butler-Sloss*. The statutory guidance is important because it is used by charities to better understand their fiduciary investment duties, and how they can make lawful financial and SI decisions. But trustee investment should not be seen as a purely financial endeavour. Indeed, the investment choices of trustees can positively impact the environment through financing a broad range of purposes. *Butler-Sloss*, for instance, showed how this could apply to climate change. That said, it is submitted that the refreshed CC14 could lead to future sectoral issues. While charity trustees may now more readily pursue investments based on positive environmental and social outcomes, this may come at the price of greater sectoral uncertainty and an erosion of the trustee–beneficiary fiduciary relationship. Unfortunately, gaps remain in the guidance in relation to: (i) the nomenclature changes; (ii) addressing conflicts of interest; and (iii) the trustees' appreciation of risk.

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99. Charities Act 2011, s 292C.
100. CC14 (n 1).
101. Legal underpinning (n 3).
102. ibid.
103. Broadway (n 87), 856.
104. ibid.
105. Ibid, 852.
106. ibid, 853.