Sustainable and responsible investing is attracting the attention of investors and investment professionals, executives and corporations, philanthropists and philanthropic organizations, and trustees and beneficiaries, particularly those identified as next-generation emerging wealth.

Fiduciary investors, whatever the motivation, face unique considerations as they address responsible investment initiatives when they invest for others because they are subject to strict fiduciary duties. Taking an exclusively financial view, the concern is the risk of underperformance. But under what circumstances is it appropriate to consider factors in addition to financial return? Times change, and the modern fiduciary seeking to align goals, duties, investments, and impact must do so in a dynamic environment.

Investment objectives can be established and success can be defined using a variety of criteria including returns, risk management, and societal impact. Responsible investment that considers societal impact is a trend with growing momentum across the globe. Its increasing prevalence compels fiduciaries and wealth managers to understand the principles and implications of responsible investing.

In this article we highlight current trends in responsible investing, provide an overview of general concepts and an analysis of issues of particular significance for investors with fiduciary obligations, and discuss the implementation of a responsible investment strategy in the fiduciary context.

Trends
Environmental, social, and governance (ESG) oriented investments increased globally from $32 trillion in 2012 to more than $59 trillion in 2015—roughly half of all institutional assets worldwide, with a jump of about 37 percent for 2015. Europe leads with 75 percent of the measured ESG assets under management. Strategies and solutions include a range of passive or active management, negative or positive screening (i.e., excluding or including certain investments based upon alignment with investor values), best-of-class stock selection, and shareholder advocacy.

In the United States, more than $6.57 trillion were invested in accordance with responsible investment practices at the end of 2014, up 929 percent from 1995 (see tables 1 and 2). That’s more than one of every nine dollars under professional management in the United States. The data clearly show the positive trend in responsible investments.

Next-gen investors and philanthropists are particularly interested in responsible investing. As next-generation inheritors increasingly

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Table 1: ESG Assets under Management

<table>
<thead>
<tr>
<th>Country</th>
<th>Sustainable Investment Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa</td>
<td>$229 billion</td>
</tr>
<tr>
<td>Asia</td>
<td>$53 billion</td>
</tr>
<tr>
<td>Australia/New Zealand</td>
<td>$180 billion</td>
</tr>
<tr>
<td>Canada</td>
<td>$945 billion</td>
</tr>
<tr>
<td>Europe</td>
<td>$13,608 billion</td>
</tr>
<tr>
<td>United States</td>
<td>$6,572 billion</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$21.6 trillion</td>
</tr>
</tbody>
</table>


Table 2: Sustainable and Responsible Investing in the United States, 1995–2014 (in billions)

<table>
<thead>
<tr>
<th></th>
<th>1995</th>
<th>1997</th>
<th>1999</th>
<th>2001</th>
<th>2003</th>
<th>2005</th>
<th>2007</th>
<th>2010</th>
<th>2012</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>ESG Incorporation</td>
<td>$166</td>
<td>$533</td>
<td>$1,502</td>
<td>$2,018</td>
<td>$2,157</td>
<td>$1,704</td>
<td>$2,123</td>
<td>$2,554</td>
<td>$3,314</td>
<td>$6,200</td>
</tr>
<tr>
<td>Shareholder Resolutions</td>
<td>$473</td>
<td>$736</td>
<td>$922</td>
<td>$897</td>
<td>$448</td>
<td>$703</td>
<td>$739</td>
<td>$1,497</td>
<td>$1,536</td>
<td>$1,720</td>
</tr>
<tr>
<td>Overlapping Strategies</td>
<td>N/A</td>
<td>($84)</td>
<td>($265)</td>
<td>($592)</td>
<td>($441)</td>
<td>($117)</td>
<td>($151)</td>
<td>($981)</td>
<td>($1,106)</td>
<td>($1,350)</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$639</td>
<td>$1,185</td>
<td>$2,159</td>
<td>$2,323</td>
<td>$2,164</td>
<td>$2,290</td>
<td>$2,711</td>
<td>$3,070</td>
<td>$3,744</td>
<td>$6,570</td>
</tr>
</tbody>
</table>

become involved in private family foundations at earlier ages, and as more than $30 trillion in wealth is estimated to pass from baby boomers to subsequent generations by 2050, the positive growth in responsible investing is expected to continue.3

Background
Socially responsible investing, sustainable and responsible investing, and environmental, social, and governance factors, mission investing, and impact investing are familiar concepts to some and novel to others. The terminology continues to evolve.

Socially Responsible Investment
Socially responsible investing historically has focused on addressing social ills through investment initiatives.4 Dating to the anti-slavery efforts of the Quakers in the 1700s, it garnered renewed attention in opposition to apartheid in South Africa in the 1970s and 1980s and more recently in Rwanda.

Sustainable and Responsible Investment and Environmental, Social, and Governance Factors
Sustainable and responsible investing is a somewhat broader concept than socially responsible investing, and it is described as “an investment process that considers the social, environmental and ethical consequences of investments, both positive and negative.”5 It places more emphasis on long-term investment with reduced risk and improved shareholder value—long-term responsible investing.6 Screens often are employed to incorporate identified priorities into the investment process.

ESG considerations are trending toward mainstream. The strong growth in ESG investment returns has led to a proliferation of academic studies analyzing ESG-oriented strategies.7

Impact Investment
Impact investing involves a more direct approach whereby targeted investments are made in private markets for the purpose of achieving a particular impact or result. The strategy is used increasingly by philanthropists and philanthropic organizations to fulfill their missions, supplementing traditional charitable contribution and grant-making approaches.8

Philanthropic Program-Related Investments and Mission Investing
Program-related investment (PRI) and mission investing are philanthropic strategies. PRIs are made by charitable foundations to further charitable missions such as low-interest loans for needy students. Mission investing, on the other hand, is the investment of investable assets to fund future philanthropic goals in a manner that is aligned with an organization’s mission. These are discussed in detail below.

Principles for Responsible Investment
In April 2006, the United Nations set forth its Principles for Responsible Investment (the Principles). As of January 2016, 1,465 signatories had aligned with the Principles.9 The Principles are focused on the implementation of voluntary and aspirational responsible investment initiatives, with key themes of transparency, accountability, and continuous improvement in responsible fiduciary investment.

Responsible Investors
Responsible investors comprise the full spectrum of investor-types—from individual investors who establish investment, philanthropic, family, and wealth planning objectives based on personal values and goals with few outside limitations; to corporate trustees or fiduciaries of private multi-generational trusts owing duties to multiple beneficiaries amid extensive financial-services regulations. The type of investor, beneficiary, and goal all factor into the consideration and implementation of any and all types of responsible investment initiatives.

Individuals
An individual’s goals and values determine the allocation of resources and will shape investment activity and policy. With few exceptions, individuals may invest resources as they wish; may freely make gifts, charitable or otherwise, to directly address a particular issue; and may incorporate responsible investment considerations into broader investment strategies. Nevertheless, federal and state tax and securities laws should be considered. For example, charitable contributions and investment in state and local bonds are tax-favored.10 Investments in private equity funds are limited under the securities laws to accredited investors.

Fiduciaries
Fiduciary investors manage other people’s assets and fiduciary obligations exist to ensure that fiduciaries act responsibly in the interests of clients and/or beneficiaries of, for example, a pension fund, a private foundation, or a private trust.

Fiduciary Duties
Fiduciary duties must be considered and addressed by fiduciaries, particularly trustees of trusts, in the specific context of responsible investment. The duties of particular relevance in this context are the duty of loyalty and the duty of prudent investment. The principal focus of this discussion is the context of trusts.

Duty of Loyalty
The duty of loyalty, perhaps the most fundamental duty of a trustee, demands that a trustee administer a trust with complete loyalty to the interests of the beneficiary and exclude all selfish interest and all consideration of the interests of third persons.11 The comments to the Uniform Prudent Investor Act (UPIA) make clear that “no form of so-called ‘social investing’ is consistent with the duty of loyalty if the investment activity entails sacrificing the interests of trust beneficiaries … in favor of the interests of the persons supposedly benefitted by pursuing the particular social cause.”12 Other authorities acknowledge that there is considerable disagreement regarding the compatibility between responsible investing and the duty of loyalty but are firm that a trustee must not promote its own views on social causes and that a settlor of a trust may authorize responsible investment and that beneficiaries may also consent to it.13

However, if expressed in the trust’s governing instrument, the duty of loyalty requires the trustee to consider the settlor’s intentions.
for investing trust funds. Even with no such explicit expression by the settlor, the beneficiary’s views and priorities may potentially be considered. Where there are multiple beneficiaries with varying interests in the trust, identifying common investment views and priorities is complex and may be unworkable.

Duty of Prudent Investment

Trustees and other fiduciary investors are subject to the duty of prudent investment of trust funds unless otherwise controlled by the trust terms, federal or state statutes, or federal or state courts. The Prudent Investor Rule is codified in the UPIA, enacted in 41 states, the District of Columbia, and the U.S. Virgin Islands, as of January 2016.14

General prudent investor rule. A trustee has a duty to beneficiaries to invest and manage the funds of the trust as a prudent investor would, in light of the purposes, terms, distribution requirements, and other circumstances of the trust.15

Reasonable care. The trustee must exercise reasonable care, skill, and caution with investments in the context of the trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust.

Diversification. In making and implementing investment decisions, the trustee has a duty to diversify the investments of the trust unless, under the circumstances, it is prudent not to do so.

Loyalty, impartiality, delegation, and costs. The trustee must (1) conform to the duties of loyalty and impartiality, (2) act with prudence in deciding whether and how to delegate authority and in the selection and supervision of agents, and (3) incur only costs that are reasonable in amount and appropriate to the investment responsibilities of the trusteeship. The trustee is expressly authorized to consider the purposes and circumstances of the trust in making investment decisions. Thus, settlors of trusts who have views on sustainable and responsible investment considerations should express these intentions in the trust terms.

Charitable Fiduciaries

Fiduciaries investing funds on behalf of charitable organizations and trusts are, in some cases, subject to stricter fiduciary obligations with regard to the duty of loyalty. Additionally, nearly all states have enacted statutes governing the investment of charitable funds; these statutes are modeled on the 2006 Uniform Prudent Management of Institutional Funds Act (UPMIFA) for charitable corporations and the 1994 UPIA for charitable trusts. A charitable organization’s internal governance documents and policies (such as its charter, trust instrument or certificate of incorporation, bylaws, investment policy, or conflicts of interest policy) also may contain relevant guidance or requirements, and donor gift instruments may contain restrictions relating to the investment of the gift’s income or principal.

UPMIFA Overview

UPMIFA replaces and modernizes the 1972 Uniform Management of Institutional Funds Act. UPMIFA provides guidance and authority to charitable organizations concerning the management and investment of funds held by such organizations, and it imposes additional duties on those who manage and invest charitable funds. As of January 2016, UPMIFA has been enacted in 49 states, the District of Columbia, and the U.S. Virgin Islands.

Which organizations are subject to UPMIFA? UPMIFA applies to charities organized as charitable trusts or nonprofit corporations and trusts managed by charities. For such organizations, UPMIFA provides modern articulations of the prudence standards for the management and investment of charitable funds and for endowment spending, modeled in part on UPIA.

Which assets are subject to UPMIFA? UPMIFA’s provisions apply to assets held primarily for investment but not to assets held primarily for program-related purposes. A program-related asset is one held by an institution primarily to accomplish a charitable purpose and not primarily for investment.17 Assets that a charity uses to conduct its charitable activities are exempt from prudent-investor norms, providing a degree of flexibility with respect to investment made to further charitable purposes.

What investment standards does UPMIFA impose? UPMIFA requires charities and their investment managers to (1) give primary consideration to donor intent as expressed in a gift instrument; (2) act in good faith, with the care an ordinarily prudent person would exercise; (3) incur only reasonable costs in investing and managing charitable funds; (4) make every effort to verify reasonable facts; (5) make decisions about each asset in the context of the portfolio of investments, as part of an overall investment strategy; (6) diversify investments, unless due to special circumstances the purposes of the fund are better served without diversification; (7) dispose of unsuitable assets; and (8) in general, develop an investment strategy appropriate for the fund and the charity.18 UPMIFA makes mandatory the duty of care, the duty to minimize costs, and the duty to investigate; in contrast, these are “default rules” under UPIA subject to the settler’s modification. The duty of loyalty is mandatory under applicable state organization law. Charitable organizations can modify non-mandatory aspirational duties in their governing instruments, subject to the charitable purposes doctrine. Additionally, the intent of a donor expressed in a gift instrument also may modify non-mandatory decision-making obligations.19

How can responsible investing be incorporated? The expressed sustainable and responsible investment goals of an institution or its donors may provide guidance to those with the fiduciary duty of prudent investment of charitable funds.

Mission Investing

Mission investing is the investment of assets by charitable organizations as tools to achieve their philanthropic goals. Mission investments are investments made by mission-based organizations that are designed to generate both a social and a
financial return. Charitable organizations utilize various types of sustainable and responsible investment strategies and vehicles with varied frequency.

Private Foundations
Some of the earliest direct impact investors were private foundations that made PRIs during the 1970s. The treatment of qualifying PRIs by the Internal Revenue Code (Code) is beneficial for private foundations seeking to make their impacts directly.

Private Foundation Excise Taxes
Private foundations are subject to excise taxes under the Code that are designed to simultaneously protect the charitable purpose upon which the foundation’s tax-exempt status is premised and deter potential abuse of tax-exempt status for private investment purposes. PRIs are afforded special treatment and are not subject to Code § 4944 excise taxes on investments that jeopardize the foundation's charitable purpose. Additionally, a foundation is permitted to treat PRIs as distributions in satisfaction of the minimum distribution requirements of Code § 4942.

Jeopardizing Investments and the PRI Exception
Code § 4944(a) imposes an excise tax on any private foundation making investments that jeopardize the carrying out of any of its exempt purposes, as well as on the foundation managers who knowingly participate in the making of a jeopardizing investment. Additional excise taxes are imposed if investments are not removed from jeopardy in a timely manner. An investment is considered to jeopardize the carrying out of the exempt purposes of a private foundation if it is determined that the foundation managers, in making such investment, have failed to exercise ordinary business care and prudence, under the facts and circumstances prevailing at the time of making the investment, in providing for the long- and short-term financial needs of the foundation to carry out its exempt purposes. Such determination is made on an investment-by-investment basis, in each case taking into account the foundation's portfolio as a whole.

A PRI is not to be classified as a jeopardizing investment. The regulations define a PRI as an investment possessing the following characteristics:

1. The primary purpose of the investment is to accomplish one or more of the Code § 170(c)(2)(B) charitable purposes (i.e., religious, charitable, scientific, literary, or educational purposes or to promote national or international amateur sports competition or toward the prevention of cruelty to children or animals);
2. no significant purpose of the investment is the production of income or the appreciation of property; and
3. no purpose of the investment is to accomplish one or more of the purposes described in Code § 170(c)(2)(D) (i.e., lobbying or political activities).

An investment is made primarily for charitable purposes if it significantly furthers the private foundation’s exempt activities and would not have been made but for the investment’s capacity to further the private foundation’s exempt activities. In determining whether a significant purpose of an investment is the production of income or the appreciation of property, it shall be relevant whether investors who are engaged in the investment solely for the production of income would be likely to make the investment on the same terms as the private foundation. However, the fact that an investment produces significant income or capital appreciation shall not, in the absence of other factors, be conclusive evidence of a significant purpose involving the production of income or the appreciation of property. Changes in the structure of a program-related investment may reduce the exempt portion of the PRI.

Section 4942 Minimum Distribution
Code § 4942 requires non-operating private foundations annually to distribute a minimum investment return (statutorily set at 5 percent) for charitable purposes. Qualifying distributions include PRIs and are treated as grants. PRI assets are excluded from the foundation’s assets for purposes of calculating the annual distribution requirement.

When the principal of a PRI is repaid to the foundation, the value is added to the distribution requirement for the year received, mandating the recycling of such funds into other PRIs or outright grants. However, if a PRI becomes worthless, there is no effect on the foundation’s distribution requirements because it is treated as an outright grant unless or until it is repaid.

Retrofitting for Responsibility
What can be done when existing documents defining powers and duties do not give trustees the needed flexibility to pursue responsible investment strategies? Bylaws, committee mandates, and investment policy statements may each be amended fairly easily; however, modernizing a long-term irrevocable trust may require much more. Judicial trust construction, reformation, or decanting to incorporate investment flexibility to express responsible investment intentions may all be possibilities to explore.

Construction and Reformation
In the case of an irrevocable trust, typical investment authority language in the trust agreement may not clearly and definitively grant a trustee authority to incorporate sustainable and responsible investment criteria or direct impact investments in the investment decision-making. If the governing instrument is ambiguous, the trustee may seek either a judicial construction or, where available, a non-judicial settlement or virtual representation agreement. If there are changed circumstances not anticipated by the settlor, a reformation to allow for responsible investment may be an option.

Decanting
Decanting is another possibility in some circumstances. A number of states have enacted some version of a decanting statute, prompting the promulgation of the 2015 Uniform Trust Decanting Act (UTDA). Trust decanting seeks to make trusts more flexible so that the settlor’s material purposes can best be carried out under current circumstances. UTDA expands the discretion already granted a trustee to permit a trustee to modify a trust either directly or by distributing its assets to another trust. Decanting may
provide a means of modernizing the investment provisions of a trust to provide clarity for the trustee and beneficiaries as to authority and limitations with respect to responsible investing. As of February 2016, UTDA has not been enacted by any jurisdictions.

Implementation of Responsible Investment for Fiduciaries
When responsible investment is desired and permitted, fiduciary investors must consider implementation. Implementation may be for an entire trust or fiduciary account, or for a portion thereof, which may be attractive for testing the waters. Before implementing such strategies, however, seeking the guidance from professionals with SRI experience is advised.

Strategies and Approaches
There are various strategies and approaches to implement responsible investing, including shareholder engagement, use of negative or positive screens, and use of hybrid and taxable entities.

Shareholder engagement. Investors in public companies are able to have a voice in the operation of the company by voting by proxy. Often, a charitable organization or endowment fund’s investment policy will outline how these proxies are voted, ideally in accordance with formal proxy voting guidelines established by the fund. Responsible investors use proxy voting as a tool for encouraging companies to improve transparency and accountability to shareholders, as well as to improve companies’ management of ESG issues. Shareholder engagement will have varying degrees of success in different markets.

Positive or negative screens. Positive and negative screening can be used to further the charitable organization’s purposes and avoid investments that do not meet the organization’s sustainable and responsible investment criteria. Where the priorities are clearly identified, development of an investment screen is relatively straightforward. Positive screening identifies companies with a commitment to responsible business practices that produce positive products and services or that address environmental or social challenges. Negative screening can be used to identify and avoid investments that do not meet the organization’s identified sustainable and responsible investment criteria. To help owners and managers ensure that investment decisions comply with mandates, MSCI ESG Research and others provide research on publicly traded companies involved in certain business activities.

Hybrid entities. Sustainable and responsible investment strategies can be implemented through a number of hybrid entities. These include benefit corporations, B-corporations, and L3Cs (low-profit limited liability corporations and flexible benefit corporations).21

Taxable social enterprises. The use of taxable entities, such as limited liability companies (LLC), to advance philanthropic efforts has grown in popularity. In December 2015, Facebook founder Mark Zuckerberg announced that he and his family will give 99 percent of their Facebook shares during their lives to the Chan-Zuckerberg Initiative, a taxable LLC, in order to advance their philanthropic goals. As the Chan-Zuckerbergs explained, by using a taxable entity, the family will be able to go beyond traditional grant-making and invest in companies, lobby for legislation, and seek to influence public policy debates, which nonprofits are prohibited from doing under the tax laws. Similar initiatives have been previously organized by Google and by eBay founder Pierre Omidyar.

Developing a Responsible Investing Policy and Process
Policy and process are the cornerstones of prudent fiduciary investment. Beyond the governing instrument requirements discussed above, development of the investment policy statement, due diligence, monitoring, and evaluation are all important considerations for the fiduciary investor.

Responsible investors should develop a sustainable and responsible investment policy.22 Asset allocation and investment risk should be considered in developing a sustainable and responsible investment policy. See the sidebar for suggestions about developing a sustainable and responsible investment policy statement.

Evaluating Investments
Due diligence in the selection of investments and the monitoring of performance are essential elements of risk management for the

DEVELOPING A SUSTAINABLE AND RESPONSIBLE INVESTMENT POLICY STATEMENT

SAMPLE FORMAT

I. Purpose
   a. Why are you developing the policy?
   b. What are the core principles?
   c. What is the scope—to what will the investment policy statement apply?

II. Objectives
   a. Articulate intent of policy
   b. Expectations for investment returns
   c. Specific cash flow goals
   d. Time horizon

III. Investment Guidelines
   a. Parameters for diversification
   b. Acceptable asset classes
   c. Target range for asset allocation
   d. Incorporation of sustainable and responsible investing
      i. Positive/negative screening
      ii. Guidelines for shareholder activism

IV. Evaluation
   a. How will you measure success?
      i. Quantitative: performance vs. specific benchmarks
      ii. Qualitative: investments comply with investment policy statement?
   b. Specifying any reporting requirements
fiduciary investor; they are pillars of prudent investment. The United Nations Environment Programme’s Fiduciary II Report includes 10 questions for trustees to consider in implementing various sustainable and responsible investment strategies. See the Impact Reporting and Investment and Reporting Standards and the Global Impact Investing Rating System reports for additional information for evaluating responsible investments. Other impact evaluation, monitoring, and measuring services and resources continue to emerge.

Conclusion
Sustainable and responsible investing is clearly an emerging consideration in the investment process. For fiduciaries, the positive impact of sustainable and responsible investing must be considered in the context of their fiduciary duties and obligations. To make prudent investment decisions, the purposes and circumstances of a trust must be considered. A statement of intent or an investment policy statement will greatly benefit fiduciaries’ implementation of sustainable and responsible investment strategies.

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Endnotes
6. For a discussion of the six principles for responsible investment, see this page of the United Nations’ website on the project: http://www.unpri.org/about-the-six-principles/.
11. Restatement (Third) of Trusts § 78; The Law of Trusts & Trustees § 543.
13. Restatement (Third) of Trusts § 90 cmt. c.

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