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ESG and the Accordia Portfolios.

The concept of ESG (Environmental, Social & Governance) Investing was discussed in an earlier edition of the Accordia Advantage newsletter. We discussed what ESG Investing was, and how it would begin to influence investor decisions in the future, especially now that environmental concerns are becoming a major global problem.

The concept of ESG investing is now becoming a widely discussed topic and is becoming an industry standard when addressing the many growing concerns investors have about the overall sustainability of our lifestyle.

Many people will have been aware of the concept of SRI (Socially Responsible Investing) which was the broad definition of this approach before ESG took over as the industry reference point. While SRI had a variety of approaches, it also had its practical problems, with a very narrow mix of investments which in themselves created additional risks with excessive concentrations of single assets.

As a matter of course, these portfolios excluded such investments as tobacco, alcohol, gambling, and arms manufacturers.

In contrast, the ESG approach has come to mean a much broader definition of sustainability. For example, when looking at the environmental impact of businesses, there are now many considerations which need to be evaluated, such as:

- Water quality in the natural environment, such as lakes, rivers and oceans.
- Air quality, a major issue in the large industrialised economies of the world.
- Ground pollution. Degradation of land, due to industrial pollutants.
- Waste Management. Efficient and effective recycling processes.
- Plastic and packaging. The minimisation or elimination of the use of these products.
- Climate change and carbon emissions. Addressing the need to actively reduce or eliminate emissions that are damaging the atmosphere.

In addressing the social impact of business activity, there are several key indicators that are evaluated:

- Equality in the workplace. How are people treated based on their gender or race?
- Civil rights. Making sure that these are always respected and supported.
- Child Labour. The elimination of child labour in the manufacture of low-cost products.
- Sweat shop working conditions. Avoiding any enterprise who employs people in a poor working environment on minimal wages.
- Workplace safety. Respecting the need for a safe working environment that does not endanger health or lives.

There are significantly more variations on these key points.

Governance is the other key consideration for investment managers. It has always been a key area of research by investment managers. It has also evolved over recent years to cover management and governance issues as they relate to Environmental and Social matters.

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There is now a lot more pressure on the boards of companies, especially public listed companies to demonstrate effective governance processes. Unfortunately, in New Zealand, we have seen a few high-profile cases in recent times where the effectiveness of the governance function of these Boards has been justifiably called into question.

A positive feature of this area over the last few years however, is a much greater alignment between investors financial interests and ESG or sustainability objectives. It is no longer seen as mutually exclusive to achieve both.

In the past, there have naturally been concerns from investors that too much of a focus on exclusions from portfolios would impact on long term performance in a negative way, especially for investors with long investment horizons such as retirees. There was also the competing concern that too little focus on this by business and fund managers would result in too much environmental damage for future generations.

There is now a recognition that ESG issues can be addressed when building investment portfolios, which also incorporate required performance characteristics that will achieve long term investor objectives.

There has also been a significant shift in the broader community around these issues. There is much greater awareness of the risks that we all face in the areas outlined earlier. As a result of this increased awareness, these issues have become much more mainstream, resulting in pressure from the electorates on local and central government to enhance and create regulations to address the concerns the community has in this area.

There have been natural tensions as businesses adjust to this broader and new set of challenges, and there will be ongoing debate as to how to move forward. What is increasingly clear however is that real progress is being made on this front.

One of the results of this new thinking and approach, is the emergence of new opportunities in the commercial sector with new and emerging technology. For example, the massive investment in solar energy technology around the world, along with similar huge ongoing investment in electric vehicles.

The impact of social media is also not to be underestimated, where the platform for communication on these matters can take place seamlessly. It is also a forum where government, businesses and other entities are being made more accountable to interest groups in the community.

At Caliber, the manager for the Accordia Portfolios, we have always addressed ESG as an integral component in our research, analysis, portfolio construction and ongoing monitoring and review. It is our belief that there is a natural alignment between ESG and longer-term performance that is totally consistent with our clients' long-term objectives.

From a research perspective, when we are looking at investment solutions and fund managers, a core part of our process is to address ESG issues. For example, when we visit managers in the United States, the U.K, Asia, Australia and New Zealand, we always ask how they address ESG within their portfolio construction processes.

We have had some interesting discussions about the effectiveness of different approaches. Traditionally, there has been a view that fund managers should exclude any problematic companies from their portfolios. However, many fund managers have found that this approach is less effective than positive engagement.

Positive engagement means that fund managers invest in these companies, and then use their shareholding to influence Boards and management in a variety of ways to meaningfully improve their performance on ESG issues as they apply to that company. This has proven to be a far more effective approach to improve the outcomes for these companies, and it has also improved their financial performance. One New York fund manager that Caliber had visited had several examples of this process working in real time.

By working through these issues at a portfolio strategic level, and then with fund managers, we can continue to develop and evolve ESG outcomes within the Accordia Portfolios.

When this is combined with substantial advances in thinking and creativity within the broader community which has then generated commercial opportunities, it has created an environment where investors can have confidence that both ESG and performance issues are being addressed.

The Trust Act 2019. Key changes ahead for trusts in New Zealand.

We have written about pending legislative changes coming with the introduction of the new Trust Act in past editions of the Accordia Advantage newsletter.

Many of our clients are settlors, trustees and beneficiaries of trusts, or as volunteers with charitable trusts. However, despite the popularity of trusts, the law relating to trusts is often archaic and difficult to follow.

Over a 10-year period, the Law Commission has led a comprehensive review of existing trust legislation, with a view to modernising the law and to make it generally more accessible and understandable. The review culminated in the enactment of the Trusts Act 2019, which was passed into law in July 2019. The new act will take effect on the 31st of January 2021.

The new legislation will impact on a very large number of New Zealanders, as it is estimated that there are between 300,000 to 500,000 trusts in existence. New Zealand is estimated to have the highest number of trusts per capita than any other developed economy in the world.

The new act has significantly modernised previous legislation and recognises the significant social and family changes that have occurred over the last 60 years. It contains much more explicit provisions that will make the process of ongoing management of trusts much clearer.

Overall, the Act increases the compliance requirements imposed on trustees, improves beneficiary rights to access information and increases the scope for beneficiary claims against trustees and professional advisors. Trustees and their professional advisors will need to ensure that they understand the key features of the Act and consider what they need to do to prepare for the changes that will take effect in 2021.

What then is the key purpose of the new Act?

An overarching focus of the new Act is to encapsulate the core principles of the law as it relates to trusts in New Zealand. In brief, it now provides for default administrative rules for trusts, providing processes for the resolution of trust related disputes, and making the law of trusts more accessible and understandable.

It is important to note that the act applies to all express trusts. Express trusts include private family trusts created by signed trust deeds, trusts created in will, (also known as testamentary trusts), charitable trusts, and large investment trusts. It is important to note that all trusts covered by this definition that either exist or that are created before the act takes effect in 2021 will need to comply with the Act at that time.

A key element of the new act is to make the law of trusts more accessible to anyone who is involved with a trust by summarising hundreds of years of legal precedents into a single piece of legislation. The intention of the new Act is that anyone with a question about the law should be able to refer to it by reading the act themselves.

Overall, most of the new act does not significantly change the existing law as it relates to trustee best practice for administration and management. A by-product, however, is that the Act will inevitably “raise the bar” for trustees, as previous requirements regarded as best practice now become the minimum legal standard for future trust administration.

What are trustee obligations?

The new act Incorporates several key changes. One of the major changes are the disclosure obligations that are included in the new legislation. The obligation is on trustees to notify a person that they are a beneficiary, and to advise that they have a right to request further information about the trust. This is one of the most significant changes, and in many cases would not have been anticipated by settlors when their trust was established.

The act further details the factors that trustees must consider when determining whether to notify a person that they are a beneficiary of a trust, and the appropriateness of providing any information about the trust on request. While the factors that trustees must consider reflect existing law, trustees in future will need to take careful note of their legal obligations around disclosure, and to consider how disclosure should be managed. A key consideration could be the impact that beneficiary’s awareness of a trust may have on future requests for information.

Trustees will not have an absolute obligation to disclose information to beneficiaries when asked to do so; trustees will retain some discretion about what to disclose. However, when exercising this discretion trustees must consider the 13 factors specifically listed in the Act before making their final decision. Those factors include considerations such as the nature of beneficiary interests, beneficiary ages, any confidentiality obligations and the effect the release of information could have on family relations.

These requirements have significant implications in practice. Most trusts in New Zealand are private family trusts established by parents for the benefit of themselves and their children. The trustees of such trusts often do not advise the children (or grandchildren or other potential beneficiaries) that they are beneficiaries and that they can request information, and nor do they regularly consider what information should be provided. Furthermore, some trusts have allocated income to beneficiaries over many years (to take advantage of beneficiary tax rates) without paying such income to those beneficiaries, creating current account debts payable to those beneficiaries upon demand. Disclosing the existence of those debts to entitled beneficiaries could lead to repayment demands by those beneficiaries.

There will be a requirement for trustees to maintain all key documents of the trust. These would include a copy of the trust deed, and any variations, a copy of any memorandum of wishes, full records of trust assets and financial statements, any contractual agreements entered into by the trustees, and of course, the minute book, and records of trustee resolutions. These documents must be retained by the trustees for the duration of the trust. This obligation on trustees will inevitably have an impact on how professional trustees hold and manage trust documents on behalf of their trust clients going forward from here.

Trustees must have a documented strategy for the management of investments. This is underscored by the requirement for trustees to invest prudently, and to have records supporting their reasons for holding particular investment portfolios or single assets.

The act is explicit in defining both mandatory and default duties on trustees. Mandatory duties cannot be avoided by the terms of the trust and sets out the basic requirements of trustees to know the terms of the trust, and to follow them. They must act honestly, and for the benefit of the beneficiaries, and according to a proper purpose. There are several other obligations that trustees will need to familiarise themselves with before the act comes into force in 2021.

Another change in the new act is an extension to the maximum term of a trust. The maximum term of a trust is extended from 80 to 125 years (although this extension is not automatic for existing trusts).

There are changes in the new act relating to Trustee Liability. This will impact on trustees' ability to either exclude or limit their liabilities, and the trustees' right to be indemnified from trust property. These changes are likely to change how professional trustees manage their trusteeships going forward from here.

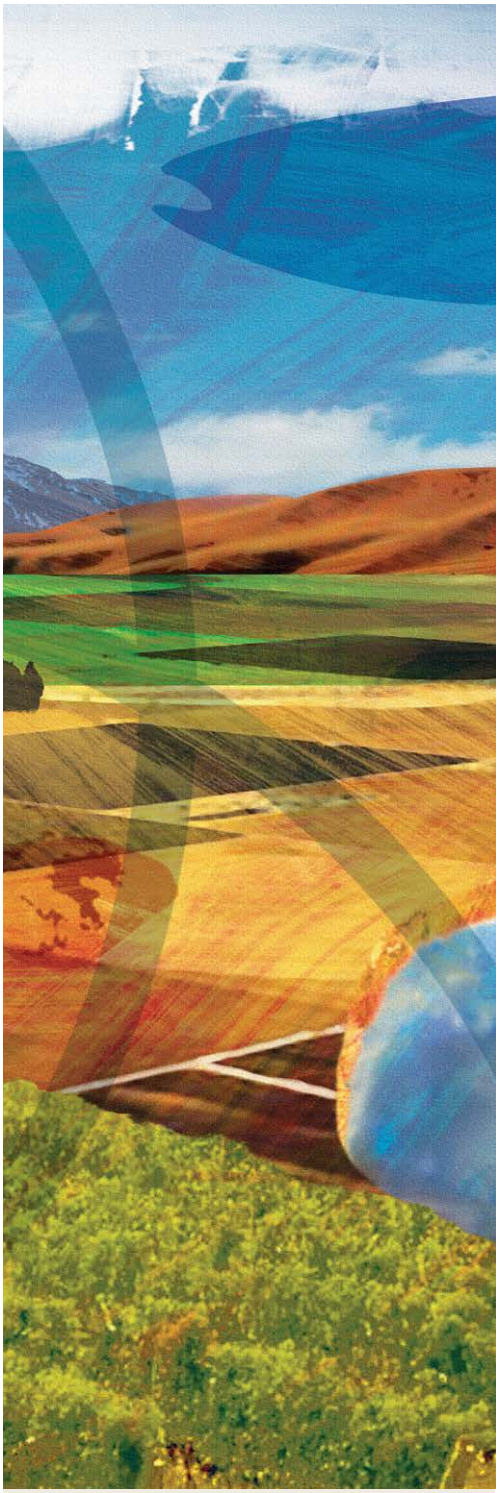
There are also changes to the law regarding the ability of trustees to delegate their powers and functions. In broad terms, the new provisions in the act increase the circumstances in which their powers and responsibilities can be delegated but restrict the timeframe during which the delegation is effective.

There are further key changes relating to dispute resolution, and the powers to appoint new trustees, and to remove trustees who can no longer perform their duties.

The Bill gives courts the power, on application by a beneficiary, to review any act, omission or decision of a trustee on the grounds that such act, omission or decision was not reasonably open to the trustee in the circumstances. Courts will be able to set aside any act or decision of a trustee, restrain a trustee from taking a proposed course of action, and make any other order considered necessary.

Broadly speaking, as well as modernising trust legislation, the Trusts Act increases rights and protections for beneficiaries but at the same time imposes more responsibility and prescriptive requirements on the trustees of family trusts. The changes are likely to make trusts more transparent for beneficiaries but also more intensive to administer for trustees and could lead to changes both to trust documentation and administration.

As noted earlier, the Trusts Act will come into effect 11 months from now, in January 2021. While this might seem quite some time away, there is a lot that trustees should be considering as a result of the new Act and time could pass very quickly. The new rules will apply both to new trusts and existing trusts, and it will be advisable for existing trusts to be reviewed and in some cases possibly varied or wound up.



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