Parry Field Lawyers

Legal Opinion on Enabling Impact Investing

To:

Rātā Foundation Leighton Evans, CEO
Foundation North, Liam Sheridan, Head of Foundation Services
Impact Investing Network, Alastair Rhodes, Chair
Ākina Foundation, Nicola Nation, CEO
The Tindall Foundation, John McCarthy, GM
Community Finance Limited, James Palmer, CEO
Christian Savings Limited, Dan Mazengarb, CEO
Otago Community Trust, Jemma Adams, CEO

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Introduction

Impact investing solves problems, while making money.

This legal opinion explains why Trustees now have an obligation to consider not just financial returns, but also the impact of their capital investments.

There is an opportunity to put a trust's money to good use – advancing the trust's charitable purpose through investment. But trusts with funds typically do not engage in impact investing.

Instead, many only consider doing good with the profits that come from capital, rather than investing the capital itself for good causes.

Paradigm shift

Use your trust's investments twice. Use income from capital to invest and give out grants, but also place capital in investments that have direct charitable impact while making money.

These investments can often achieve impact that is "mission aligned" with the problem the funds were set aside to address.

While this opinion is focused on Trustees, our view is that the same principles would apply to any entity, such as an incorporated society. In other words, when looking at how to invest an entity's funds, it should consider the purpose for which the entity was set up.

We are happy to discuss any of this in more detail with anyone who is interested.

Would you rather hear this on *Seeds Podcast?*
Visit: theseeds.nz/barriers-to-impact-investment

Steven Moe

Partner
Parry Field Lawyers
stevenmoe@parryfield.com
021 761 292

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Summary and examples

In the past, Trustees thought about how the income that came from the capital they invested could be used to do good.

The new Trusts Act 2019 (the Act) lets us reframe this – it references the purpose of the Trust itself and the need to bear that in mind when investing.

This means that Trustees should also look at where they invest capital and how it advances the purpose and has impact, as well as what to do with the income.

A moment to pause: Is this for us, or not?

Are you open to using your funds for impact through investment, as well as using the income?

If so, keep reading. It will unveil a compelling new way of looking at the world that you likely cannot ignore. If not, then it is probably best to put this document aside and turn to something else.

Watch the Video

Find a video of Shamubeel Eaqub and Steven Moe discussing this document, along with other free resources, on the Parry Field Impact Investing Information Hub

https://www.parryfield.com/impact-investing-information-hub/

Traditional fund management
Growing and gifting

Capital invested → Income of capital

Capital invested ↓ Keep it safe

Income of capital ↓ Use for impact

Example:
Traditional investment: Mainstream bank term deposits
- Perceived to be “safe”. Financially driven.

The new approach
Investing for impact, then gifting

Capital invested → Income of capital

Capital invested ↓ Keep it safe | Invest for impact

Income of capital ↓ Use for impact

Example:
Impact investment: An iwi-led education startup
- Purpose driven. Direct impact. Educates people while generating financial return.

Part 1: Perceived barriers to impact investing

Many charitable trusts, community foundations or family offices have funds which were set up to address one of the four charitable heads: advancing education; relieving poverty; advancing religion; or promoting purposes beneficial to society.

Some of these entities hold tens of millions of dollars, and some hold a lot more. Together, there are billions of dollars' worth of funds that could be used cleverly to achieve more impact. The rise of impact investing has seen a collision between ways of thinking about how those funds could be used.

There are also different types of impact investing – some return market or above-market rate returns, some return slightly less than market, and others are done without return (this might be better thought of as a grant).

Trustees must undertake due diligence to ensure the potential investments are actually having impact.

Impact investing does not necessarily mean risky investing. In fact, our experience is that most impact investments do as well as or better than "safe" investments.

Funders who claim all their non-impact investments always produce a market return are also probably not being accurate, but it doesn't stop them continuing to invest that way.

Sometimes the current Trustees are aware of why their funds were established and the purpose of advancing those charitable ends. Despite that, they may argue that there are not enough such opportunities to invest in. In truth, there are increasing numbers of impact investment opportunities across all mission-aligned areas including education, the environment, housing, health and technology.

Some entities have additional considerations. For example, they may be owned by a local government body who may have expectations about where funds are invested, and their returns. Others may be part of a bigger movement (e.g. a church denomination) which may have constraints to consider.

But the two most common barriers to embracing impact investing for most entities are:

- their statutory and fiduciary duties; or
- their SIPO wording.

Let's consider each of them.

SIPO wording

A SIPO (statement of investment policy and objectives) sets out how investment is done, governance is provided, the strategy to be followed and the objectives for a fund.

Some Trustees point to wording in their SIPO which they argue constrains the ability to make impact investments. It is possible that SIPOs which were drafted in the past do have such limitations. If that is the case, the answer to this is simple: amend the SIPO to allow a wider conception of investing.

When making investments, Trustees should consider the context and objectives of the trust – these are important and should form the foundation for the SIPO. This means considering how to maximise impact, not just what may yield maximum financial return or preserve capital investments that are "safe".

Some groups have expanded their wording to allow investment in derivatives which are not always readily understood and may be risky. So, it would be reasonable to change a SIPO for something much more understandable: impact investment.

A starting point

As a starting point, a SIPO could identify a percentage figure to be allocated in this way, so the Trustees can "dip their toes in the water" of impact investing. In Appendix 1, we have included model wording that could be used to update a SIPO, to empower and enable impact investing.

Another way to get started would be to join an existing impact fund before investing independently.

Considering fiduciary duties

The Act outlines duties for trustees, but it is not a definitive code of the law of trusts. It sits alongside the common law[1].

"Equitable principles" are historical common law principles which exist outside of the Act. These also categorise the Trustee-beneficiary relationship as "fiduciary" – the Trustee has a duty of loyalty to the beneficiary.

A Trustee has overarching fiduciary obligations. The position of Trustee, as the name implies, is one of trust and confidence[2].

There is not a definitive list of fiduciary obligations. The precise circumstances of each situation are different[3]. However, the duty of loyalty is fundamental[4].

Important loyalty obligations include Trustees avoiding conflicts of interest, and not profiting[5,6].

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[1] The Trusts Act, s 5

[2] Lindsay Breach, Nevill's Law of Trusts (14th ed, LexisNexis, Wellington, 2023) at 99.

[3] Chris Kelly and Greg Kelly, Garrow and Kelly: Law of Trusts and Trustees (8th ed, LexisNexis, Wellington, 2022) at 797.

[4] Breach, above n 2, at 99.

[5] Keech v Sandford (1726) Sel Cas King 61

[6] Kelly and Kelly, above n 3, at 398.

Photo by Tyler Lastovich

Considering statutory duties

As well as fiduciary duties, Trustees have duties set out in the Act.

The duties of Trustees in Part 3 of the Act limit how Trustees can act when managing and investing trust property. There are two types of duties:

- **Mandatory duties**. These cannot be modified, and override whatever is in a Trust Deed.
- **Default duties**. These apply unless they are changed by the Trust Deed of the entity.

The mandatory duties are set out in sections 23 to 27 which state that Trustees must:

- know the terms of the Trust;
- act in accordance with the terms of the Trust;
- act honestly and in good faith;
- hold or deal with the assets of the Trust to further the purpose of the Trust; and
- exercise their powers for a proper purpose.

In section 26(b), the exact wording is:

> *"hold or deal with trust property and otherwise act ... to further the permitted purpose of the trust, in accordance with the terms of the trust".*

The Default duties are set out in sections 29 to 37, and include:

- a general duty of care;
- to not exercise power for own benefit;
- to consider exercise of power;
- to not bind or commit Trustees to future exercise of discretion;
- to avoid conflicts of interest;
- impartiality;
- a duty to invest prudently;
- to not profit; and
- to act for no reward.

Historically, Trustees have commonly understood the framework on duties. However the landscape has changed with the Trusts Act 2019, permitting a wider view of what these duties entail.

Note we have discussed charitable trusts rather than other legal entity types such as incorporated societies, which have their own specific requirements.

Part 2: A reframing for duties and obligations of Trustees

Our view is that the game has changed for what a Trustee needs to think about when making decisions. The Trusts Act 2019 outlines the powers and duties of Trustees and opens up new possibilities compared to previous legislation.

Let's consider three principles that show this.

Principle 1: What Trustees should consider

Trustees should be thinking beyond just financial returns.

The Law Commission proposed that the Act should clarify that the power to invest does not prevent a Trustee from considering other relevant matters when determining how to manage a trust fund.

This might involve buying property for non-investment purposes to help the trust's purpose or objectives[7].

The Act itself, in section 56 and 58, gives Trustees the necessary powers to manage the trust property and invest that property.

Some matters (among others) that Trustees may consider include[8]:

- the purpose of the trust;
- the desirability of diversifying trust investments; and
- the Trustee's overall investment strategy.

Principle 2: The purpose of the Trust

Section 26 requires Trustees to act "... to further the permitted purpose of the trust...", so Trustees do need to consider that.

As well as that, the Act provides a new framework for Trustees, requiring them to consider the context and objectives of the trust in section 21. This states that the "Guiding principle" is:

> *"In performing the mandatory duties set out in sections 23 to 27 and ... default duties set out in sections 29 to 38, a Trustee must have regard to the context and objectives of the trust."*[9]

To consider "the context and objectives of the trust", Trustees should think about the original reason for the trust and its purposes, not just which investment will yield maximum financial return or preserve the capital with the safest investment possible.

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[7] Law Commission, Review of the Law of Trusts: Preferred Approach (NZLCIP 31, 2012) at 90.

[8] Trusts Act 2019, s 59.

[9] Trusts Act 2019, s 21.

Photo by Emmanuel Ikwuegbu

Principle 3: The ability to modify certain duties

The terms of the trust can modify or remove some duties that are not mandatory, such as:

- **The general duty of care**[10]. This requires Trustees to exercise reasonable care in skill in the circumstances, having regard to their special knowledge or experience[11].
- **The duty to invest prudently.** This requires Trustees to exercise the care and skill a prudent business person would exercise in managing the affairs of others, when investing[12].

When making investments that would bring in below-market returns or no returns at all, Trustees may be seen as failing their duty to invest as a prudent business person. But that needs to be balanced with the wider considerations and purpose of the trust.

Also, impact investments are likely to be just a piece of a larger portfolio. Trustees should be aware of different risks, returns and liquidity compared to "traditional" investments, so they can consider these along with the trust's objectives and purposes.

Most impact investments generate returns associated with the impact they have. Such returns may be hard to measure in financial terms, but might be measurable according to other methods that are focused on societal outcomes, such as education, culture, poverty relief, and wellness.

Trusts could even incorporate a new clause allowing Trustees to invest in ways they believe advance the trust's purposes. A clause amending the normal duty could also allow investments where there may be no financial return, as long as they further the trust's purpose and objectives.

Principle 4: The role of impact in decision making

If impact investing also advances the trust's purpose in light of the context and objectives, then we consider that Trustees may actually have a duty to pursue such opportunities.

When making decisions about investing, the Trustees can now consider other relevant matters, such as whether they should invest in impact. It may be that impact investing can further the trust's purpose, and so Trustees should invest in that way.

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[10] Trusts Act 2019, s 28.
[11] Trusts Act 2019, s 29.
[12] Trusts Act 2019, s 30.

Overseas developments

We do not operate in a silo of thought, and the principles discussed here are also being discussed across the world. As an example, in the United Kingdom a recent case looked at trustees and "non-financial considerations"[13] when looking at investing.

The Judge started by noting that the charitable purpose is the starting point but then considered the grounds that could justify a decision to invest for impact:

> *"Charity trustees' primary and overarching duty is to further the purposes of the trust. The power to invest must therefore be exercised to further the charitable purposes."*

While specific to the UK and the context of the facts of that situation, it is worth considering their approach. This shows that the duties associated with impact investing are being considered in the UK, and so should not be off limits here.

In Australia, guidance from the Australian Prudential Regulatory Authority, which regulates their banks and super funds, has stated that a regulated fund:

> *"… may incorporate objectives from investments, such as environmental or social impact related objectives, where it can demonstrate that pursuing such additional objectives is consistent with the outcomes the [regulated superannuation fund] seeks to provide to beneficiaries"*[14].

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[13] See Butler-Sloss & Ors v The Charity Commission for England and Wales & Anor [2022] EWHC 974 (Ch) (29 April 2022), and for a summary of it see this article from Bates Wells.

[14] See Guidance SPS 530 (https://www.apra.gov.au/consultation-on-prudential-standard-sps-530-investment-governance-superannuation) regarding ESG on pages 17 and 18, at paragraph 49.

Mission drift warning

Before rushing to embrace impact investing, there is a high-level consideration and potential danger for those organisations who have not yet developed an understanding of why they exist and have not yet ensured that missional thinking permeates all aspects of what they do.

There could be a drift away from the core purpose of what the organisation was set up to do (using funds for impact) if it starts investing in anything that is "good" without considering the link that each individual investment has back to the core purpose.

Boards may need to develop or sharpen a razor focus on their "why" as a first step. Instead of being reactive to the need, **be proactive** – consider what the organisation is there for.

Simply adopting an unrefined mentality of "invest for impact" may end up diluting the organisation's purpose or even introduce new purposes.

Be wary of chasing the changeable winds of impact – they may be far removed from the problems the organisation aims to address.

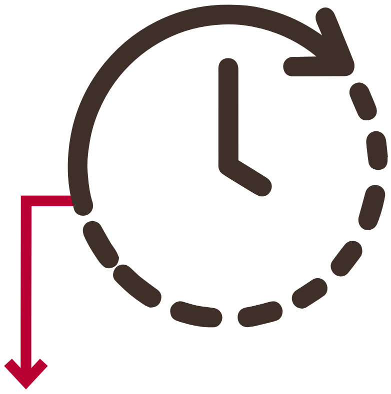
Otherwise, simply adopting a mentality of "invest for impact" may end up diluting the organisation's purpose or even introduce new purposes, as it chases changeable winds of impact to fill sails that are far removed from the problems it was set up to address.

This is a foundation-level point that Boards need to consider and get right before they start building their approach to impact investing. The aim is to ensure that the "impact investment arm" is aligned with their "missional arm", and the two are working together in unison to advance the core purpose. Impact investing becomes one way of imaginatively engaging with the problem.

It is important for Boards to be aware of the risks of mission drift, so they can get impact investing right.

Part 3: Nine practical realities

In our experience, there are some practical realities to consider in the paradigm shift of thinking about how to invest trust funds for impact.



Reality 1

Change takes time to implement:

Patience is key. Not everyone will be familiar with this way of thinking, so it is important to take everyone on the journey of understanding with you.

Involve stakeholders such as management, staff, iwi, donors, recipients, government or councils.

Reality 2

You have to ask your advisors to implement your decisions:

It is no good updating the SIPO and altering the strategy on investments, if Trustees do not instruct financial advisors or fund managers to take the practical steps to implement those decisions.

Also consider if they have the professional skills or knowledge to do so.

Reality 3

You can start small:

Rather than trying to make a wholesale change, it might be most effective to have a gradual growth strategy.

Try allocating a range without a set figure, or try 2% next year, then 3%, then 4%.

Starting with small steps lets the organisation learn, and over time you can allocate more as you get comfortable. It may also be a starting strategy to co-invest with others, or invest in a fund.

Reality 4

What is your purpose:

This should be the primary concern.
It should drive the motivation for getting involved in impact investing, and guide the decision-making going forward.

Sometimes Trustees can lose sight of the purpose and miss the forest as they are so busy inspecting a tree.

Reality 5

Using the tools at your disposal:

You do not pick up a hammer to cut a branch or use a saw to hammer a nail. Select the right tools for what you want to achieve.

That can mean expanding your understanding of the legal tools available, including hybrid options that blend charity and for-profit approaches while integrating in principles of steward ownership.

Read more on these new approaches:

- Social enterprise
- Steward ownership
- Impact investing

Reality 6

Reporting on the impact:

Don't just invest for impact, also report on what that impact is.

This might involve using non-traditional ways to talk about impact that is not measured only using money.

For example, a report on investing in a housing development might talk about the children who now have homes.

Reality 7

The role of your organisation:

Consider how your organisation operates and its role in investing, by considering this quote from David Gardner:

"Make your portfolio reflect your best vision for our future.

"Always be thinking ahead. Be optimistic.

"Think about the world that you want to create, because sure enough your dollars and mine, our capital, is helping change the world."

Reality 8

Impact on governance:

There may be governance implications for the type of Trustees that should be on your Board and their skillsets.

It may be that traditional trustees need to step off. The Board may need a new mindset to consider impact and understand how to measure it.

Reality 9

Double materiality matters:

A further addition beyond an often-mentioned ESG (environmental, social and governance) or CSR (corporate social responsibility) lens, is to look at the impact of your organisation on contributing to solutions.

So, beyond “avoiding harm”, what does it look like for ESG to internally affect your organisation? And most importantly, how do you impact externally? That is the double materiality.

If we are right, funders won’t be able to escape reporting on the impact of their investments – for example with a climate or nature-based solutions lens as additional scrutiny.

Photo by Tyler Lastovich


Photo by Tyler Lastovich

Part 4: Conclusion

This legal opinion is intended to offer comfort to Trustees that they can, and should, explore impact investing.

As well as the legal shift which has occurred there are also practical steps and realities which Trustees need to consider. That includes making sure the purpose is well understood, and that the impact investing will complement it.

We hope this empowers some robust discussions at your next Board meeting about what you invest in, and why.

Parry Field Lawyers

Steven Moe

Partner
Parry Field Lawyers

Head of Impact Team
stevenmoe@parryfield.com
021 761 292

Appendix 1:
Model statement of investment policy and objectives (SIPO)

Model SIPO wording for impact investment

The essence of a clause which can be included in a SIPO to permit Trustees to consider and implement impact investing will likely contain the following elements.

Investment objectives, mission and impact

All investing has impact. Every investment produces both (i) financial results; and also produces (ii) a spectrum of other social, environmental, cultural or other results.

The Trustees will avoid a binary thinking of “either this, or that”, when considering the financial results and these other impacts.

Instead it will seek mission-aligned investing which has positive impact that is aligned with and advances its overall purpose, with financial returns.

This will involve both (i) negative screening out of misaligned investments; and (ii) positive screening by proactive and intentional seeking out of aligned opportunities.

Preserving capital and ensuring ongoing income is important. But with [10%] of its overall capital funds, the Trustees commit to seeking aligned impact investing projects.

The Trustees will measure investments using traditional financial reporting but also new methods of measuring social impact of projects it invests in.

Example

We are grateful for this summary of the key elements from The Tindall Foundation SIPO, shared by its general manager John McCarthy:

> *The Investment Portfolio must contain relatively liquid and secure investments, to enable donations of large sums at short notice, and to enable impact investments at the Trustees’ discretion...*
>
> *and*
>
> *TTF’s investment objectives include:*
>
> - *Have a significant proportion of the Foundation’s Investment Portfolio available in capital-secure, but liquid investments to enable deployment of donations or Impact Investment at short notice.*
> - *Make charitable investments/ loans from the Investment Portfolio to specific impact investment projects with community organisations or government entities (such as Social Bonds) and hold these until maturity.*

Appendix 2: What is impact investing?

This is one of the best quotes we have seen to describe impact investing, which is where investments have financial return but also social, cultural, environmental or some other returns.

"The current of impact investing is washing along the shores of a bifurcated world still organized to separate profit making from social and environmental problem solving.

"For now, this bifurcated world channels the energy of impact investors into the hidden pools and underground rivers on the margins of mainstream investment and philanthropic activity. But water has a powerful ability to reshape the world it flows through.

"The gathering weight of impact investment activity is wearing away the bedrock of seemingly immovable institutions and investment practices."

— Antony Bugg-Levine

Impact Investing: Transforming How We Make Money While Making a Difference

Centre for Social Impact: Overview of Impact Investing in Aotearoa
centreforsocialimpact.org.nz

Impact Investing Network in Aotearoa New Zealand
impactinvestingnetwork.nz

Global Impact Investing Network
thegiin.org

For additional descriptions and information, look at the sources above.

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Photo by Josiah Farrow

Parry Field Lawyers
Level 1, 60 Cashel Street,
Christchurch 8013
PO Box 744, Christchurch 8140
New Zealand

T: +64 3 348 8480
F: +64 3 348 6305
parryfield.com