Before making investment decisions it is vital that trustees understand both: (a) their powers and duties when managing, investing and reviewing the trust assets; and (b) as regards financial assets, their obligations under general company law.

This briefing considers the extent of trustees' duties when making investment decisions and how such duties impact on the decision-making process. It also includes a useful checklist of factors to consider when trustees are asked to make investment decisions. Farrer & Co has a number of specialists with experience in advising trustees on their duties and guiding them through company law issues when they are considering investments in corporate assets.

1. Powers of trustees

• The Trustee Act 2000, and most modern trust instruments, give trustees a wide power to invest in such investments as they think fit. For the purpose of this briefing we assume that the trustees have this wide power of investment, although in practice it will be necessary to check the trust deed for any specific restrictions.

2. Duty of trustees

• Having established that the requisite investment power exists, trustees must then consider whether it is appropriate to exercise that power.

• Trustees have an overriding duty to exercise their investment powers with care and prudence, seeking to establish a suitable level of risk and diversification across the entire portfolio. Section 4 of the Trustee Act 2000 sets out the standard investment criteria which trustees must consider, both when making an investment decision and also when reviewing investments from time to time.

• In addition Trustees must review the trust investments from time to time and consider, having regard to the standard investment criteria, whether they should be varied.

• Importantly, trustees have a duty to balance the interests of different beneficiaries and to act fairly when making investment decisions which could have different outcomes for beneficiaries with competing interests. Therefore, trustees must have regard to this duty when deciding to what extent they will invest for income returns or capital growth in circumstances where the beneficiaries entitled to income and capital respectively are different.

3. The decision-making process for trustees

3.1 Suitability:

• Trustees must consider whether the proposed investment is a suitable one given the wide range of investment options open to them. Taking into account the needs of the beneficiaries, the purpose of the trust and the spread and type of existing investments, trustees must consider whether it would be more appropriate to invest in other categories of investment.

• Anecdotal evidence suggests that many trustees are retreating somewhat from the more exotic investments and structured products which characterised former years and are moving back towards more traditional investment assets, such as real property, building society deposits, gilts and equities.

3.2 Diversification:

• Another important consideration is the need for diversification. Ordinarily this will involve trustees maintaining a spread of investments with a view to reducing the overall risk profile of the trust. It will be important for trustees to keep up to date with investment philosophies at the relevant time. This is consistent with the trustees' duty to continue to review and assess the suitability of investments.

• Different considerations may apply where the trust assets consist of shares in the settlor's family company. In this instance it may not always be possible or practical to diversify the trust fund. However, even in this case, the trustees must ensure that they at least consider the need for diversification (reviewing their decision at regular intervals) and keep a note of their reasons for any decision not to diversify.

• Trustees can consider the family and business circumstances and can be guided by the settlor's wishes in deciding whether to diversify but they must avoid strict adherence to the investment policy of a settlor without questioning whether it is appropriate in all the circumstances to follow such a policy.

4. Additional considerations

4.1 Delegation of investment management functions:
Trustees may appoint a discretionary portfolio manager to manage the trust investments for them; however, they must provide the manager with a written policy statement providing guidance as to how he should carry out his role. In addition, the trustees must review (and revise, if appropriate) the investment policy statement at regular intervals.

4.2 Controlling interests in companies:

- Where trustees own a large or controlling interest in a private company they cannot leave the business of that company to the directors, contenting themselves with a little information on its performance from time to time, without risk of liability. Trustees might seek a non-executive or nominee position on the board of directors; or, depending on the investment strategy, it might be prudent for the trustees to ensure that they receive timely copies of board agendas, minutes of board meetings and monthly management accounts.

- It is now common for most trust deeds to contain a clause excluding trustees from their duty to enquire and supervise. However, such a clause will not exonerate trustees if they become aware of a situation indicating that they should use their powers of intervention and they fail to intervene.

4.3 Speculative investments:

- A trust deed will sometimes expressly authorise speculative or hazardous investments. This will help the trustees to substantiate that they have satisfied their duty of care in making that particular speculative or hazardous investment. The key test will be to look at the particular investment and establish whether the holding of that investment is justified in the context of the overall portfolio. Investments which are hazardous in the sense of potentially exposing the trustees to additional liabilities must be approached with extreme caution.

4.4 Ethical investment:

- Although ethical investments have become increasingly popular in recent years, the trustees’ primary duty when selecting trust investments usually will be to obtain the best financial return for the beneficiaries so that ethical considerations will only be relevant in relation to a choice between investments of equal financial merit.

5. Corporate issues for trustees

- Trustees must also consider the corporate context of their investment decisions and, in particular, company law and corporate governance issues.

- In the case of private limited companies, trustees must be made aware of any restrictions under the relevant company’s articles of association or shareholders agreement that may be inconsistent with the terms of the trust deed (in particular, in relation to the transfer of shares by trustees, decision-making processes and non-compete undertakings).

- In the case of public listed companies, trustees should be aware of the restrictions and reporting obligations under the rules of the applicable stock exchange and other related regulations when dealing in securities of such companies. (In the UK, this would include (amongst others) the Takeover Code and the AIM Rules.)

- There are also general company law duties, restrictions and/or approval requirements if the trustees or the beneficiaries of the trust are directors or connected persons of a company in which the trust invests. Where this connection exists, advice should be taken before any investment in the company (whether private or public) is completed.

6. Checklist for trustees

The key message for trustees is that they should:

- take care;
- act reasonably;
- carry out due diligence on the investment;
- consider the needs of the beneficiaries;
- delegate, not abdicate, responsibility; and
- above all, take appropriate advice. In addition, when making investment decisions, trustees should consider the following key ten questions:

1. Is the power of investment wide enough to authorise the particular investment being considered?
2. Is the proposed investment suitable considering the range of investments open to the trustees?
3. Have the trustees taken suitable investment advice?
4. Have the trustees carried out periodic reviews as to the continued suitability of the investment?
5. Have the trustees considered the need to diversify, and its applicability to the circumstances?
6. Have the trustees shown reasonable care in choosing the investment, regard being had to the spread of investments of the trust fund?
7. Where the trustees hold a controlling interest in a company have they received sufficient information (for example, management accounts and board minutes or board reports) so as to ensure they are aware of any circumstances which may require their intervention on behalf of the trust?
8. Where trustees are making an investment in a UK private or public company, what restrictions are there under the company’s governance documents or under general company law?
9. Where trustees are making an investment in a UK public listed company, what obligations are there under rules of the relevant stock exchange or takeover code? If investment decisions are delegated, is it proper delegation rather than an abdication of responsibilities?
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