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Autor	Dominique Jakob, Peter Picht
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Sustainable Investments by Foundations from a Legal Perspective

Dominique Jakob/Peter Picht*

I. Introduction

Foundations are renowned for the contributions they make to the common good in pursuing their foundation purpose. In contrast, the management of the foundation assets, which make such contributions possible, has hitherto not been of extensive interest. One reason for this lack of interest might be the conservative investment strategy that was traditionally followed by most foundation boards. Prototypically, foundation assets consisted of - purportedly - low-risk fixed interest investments (e.g. public bonds) and the returns on these investments were spent on the realization of the foundation purpose. Yet, a growing number of foundations depart from this conservative pattern and follow a purpose-related investment approach. These foundations try to exponentiate their purpose-realizing power by choosing investments for their assets which are related to their foundation purpose. In consequence, they try to use not only their returns on investment but also the investment itself as a means to realize the foundation purpose. If this new investment approach is directed toward the

* Dominique Jakob is a professor of private law and director of the Center for Foundation Law at the University of Zurich (UZH); Peter Picht is academic assistant at the University of Zurich. Due to our main field of practice, the article is written mainly from a Swiss/German/Liechtenstein (foundation law) perspective, yet its principles can be transferred to other jurisdictions as well. The paper is based on a lecture held by the first mentioned author at the "Lisdar Congress on on Sustainable Development and Responsible Investing", 2-4 May 2012. For a more detailed analysis of the questions and thoughts addressed here, see Jakob/Picht, International Journal of Not-for-Profit Law 2012 (forthcoming).

fulfillment of sustainability purposes we may call the respective investments "sustainable and responsible investments (SRI)".

Given the fact that it is the essential duty and trait of a foundation to further its purpose, one may - at least at first guess - think that purpose-related investing foundations are "the better foundations" as they further their purpose more intensely. But foundations also face specific challenges, not least when it comes to purpose related investments, especially in the economic field of asset management and in the legal field of foundation law. This short overview tries to outline - with a focus on sustainably and responsibly (SR) investing foundations - how the challenge of reconciling SRI-concepts with foundation law principles may be met.

II. Sustainability and types of sustainable investments

The extensive use of the term "sustainability" corresponds to the vagueness of its meaning. There are numerous approaches of what sustainability and sustainable investments really are and this article cannot analyze these approaches in detail. Looking for at least a very basic definition, the concept of sustainable and responsible investment can be said to take into account the long-term economic, environmental, and social risks and opportunities of an investment. "SRI" excludes investments that violate basic international norms and it integrates environmental, social and governance factors (ESG) in its investment decisions.

Furthermore, the general SRI-concept includes numerous investment approaches. Positive screening identifies companies whose activities relate to defined industries and/or which are best performers on some indicators. Negative screening avoids businesses that fail to pass a defined threshold or which belong to sectors perceived as having a negative impact on the environment. ESG-factors are also used to determine sustainability performance of companies in relation to and comparison with their com-

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petitors (best in class-concept). However, under this approach, sustaimability leaders are selected for investment only if they also meet predefined performance requirements. No division between ESG-analysis and financial analysis exists when investing directly in companies that create solutions for ESG-challenges (e.g. water scarcity) or avoid the consequences of such issues (ESG-integrated investment). In this approach, ESG-factors are analyzed alongside traditional company data representing an additional criterion for investment decisions. Being willing to relax expectations for risk-adjusted financial returns in exchange for substantial and tangible social impacts, investors may also actively provide capital to enterprises that contribute to defined social goals (impact investment). Eventually, based on a purely financial investment decision, investors can also work directly with companies they are investing in by implementing ESG-goals, participating in shareholder resolutions or reserving the right to disinvest from non-responsive companies (responsible engagement overlay, active ownership).

III. General principles for investing foundation assets

The interaction of general foundation law and general investment principles with the particularities of SR-investments is a complex but unavoidable topic for foundations that want to invest or have invested "sustainably". The academic discussion has not yet consolidated towards a comprehensive and coherent set of legal rules for the management of foundation assets. However, some parameters have been sketched from different sides. The Swiss Federal Court, for example, regularly holds that the asset management of a foundation needs to be primarily guided by five principles: Return, liquidity, asset preservation, diversification of investments, and the avoidance of risks. And the "Swiss Foundation Code", a self-regulatory and recommendatory code of conduct (mainly) for grant-making foundations, is an important example for a "process driven approach" that focuses more on the process of decision making in investment measures. Taking these and other components as a starting point, some "cornerstone principles" can be formulated that may well guide foundation boards in their assessment of sustainable investments. Two of these principles shall be outlined here:

1. Discretion and binding prerequisites.

Although the foundation board has a certain margin of autonomy and discretion, this margin ends where either binding prescripts are made by the law or the foundation statutes or where the management and use of the foundation asset deviate from the orientation towards the foundation purpose and the will of the founder. In order to use its margin of discretion duly, the foundation board has to exert it in a four step-process of (1) determining a margin of discretion, (2) assembling the relevant and sorting out the irrelevant aspects for the decision to be taken, (3) weighing the relevant aspects, and (4) taking and implementing a decision that reflects the result of the consideration process. These rules to be followed for a due consideration process are of very high importance for the management of foundation assets, not least because foundation boards typically possess of a margin of discretion with regard to asset management issues.

2. Two levels of guiding aspects

The aspects which are typically relevant for the foundation asset management, and consequently for the due exertion of discretion in this field, can be assorted to two different "levels". On the "foundation level" we can locate the aspects that derive from fundamental principles of foundation law and from the structure of the respective foundation, such as the foundation purpose or detailed investment allegations made by the founder in the statutory documents of the foundation. The foundation purpose can imply target levels of return and liquidity that the asset management needs to meet. Besides setting the foundation purpose, the founder can make more detailed provisions how to invest and use the foundation capital. On the "investment level" range general investment principles that apply, in principal, to the management of any asset, not only the foundation asset (e.g. principle of investment diversification). This model helps to understand the relation between the aspects assigned to the different "levels": As the foundation board is bound to realize the foundation purpose and the relevant will of the founder, the "foundation level" takes, in principle, precedence over the "investment level". One example of the interaction of the two levels is the principle that foundations can and even should take appropriate risks when investing the foundation capital; core elements for determining which risks are "appropriate" are the structure of the particular foundation (foundation level) and the techniques of modern portfolio management (investment level).

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IV. Particularities of SRIs

The general principles for the management of foundation assets are of direct relevance to SRIs by foundations. This assertion may seem evident but it is nonetheless important. Although SRIs, with their often positive ecological and social effects, constitute a promising field for foundation activities, they are, from a foundation law perspective, not automatically approvable. If an investment violates foundation law principles this violation is not irrelevant just because the investment is an "SRI".

1. Statutory basis for SRI

Applying these general principles to SR-investing foundations and having regard to the statutory basis for an SRI it seems necessary to distinguish three types of foundations: For the first group of foundations, whose purpose contains an SRI-element, engaging in SRIs means to directly realize the foundation purpose. The SRI-activity is therefore not only possible, but mandatory. Yet, the SRI-purpose must be realized lastingly and in the best possible way. An SRI-purpose is by no means a carte blanche to waste the foundation capital in idealistic, but risky, investment adventures. For the second group of foundations, whose statutes (including the relevant will of the founder) address SRI-activities without making them part of the foundation purpose, much depends on the way the SRI-issue is addressed. The most relevant example will be a board that aims at realizing a non-SRI foundation purpose by using the returns of an SRI invested asset. If, for example, the foundation board has large margin of discretion how to execute SRIs, the two level-structure of relevant asset management aspects comes into play. According to this structure, the foundation board must conceive the SRIs in a way that best serves the foundation purpose, even if ESG-factors may advocate a different investment policy. For the third group of foundations, whose statutes do not mention SRI-activities, it is not self-evident that the foundation board is allowed to invest SR at all. Even if an interpretation of the statutes and the will of the founder shows that the foundation can invest SR, no negative impact on the realization of the foundation purpose can be justified by SRI-particularities.

2. Adapting the right approach

From the different SRI-approaches the board has to choose - or to develop and implement step by step - an approach that is adapted to the characteristics and the resources of the foundation. And the board has to establish working structures that foster the success of the foundation’s SRIs. As SRIs are a relatively new class of investments that tends to present greater risks than many conventional investments, the asset management with regard to SRIs must employ a considerable degree of care and specific knowledge in order to make sure that the investments chosen are indeed "SRI" and that unnecessary risks and losses are avoided.

3. Foundation planning

From the ex ante-perspective of a prospective founder, the SRI-activities of his future foundation become a question of "foundation planning". The foundation statutes and the will of the founder are the crucial determinants for a sustainability-orientation of the future foundation. In shaping the SRI-dimension of its foundation the founder should observe - among many other relevant elements - the fundamental maxims of (1) seeking (SRI-)expert advice, (2) clearly prescribing the if and how of a future SRI-policy, while (3) forbearing from regulating each and every detail of future SR-investments.

V. Closing remark

Even this short introduction shows how complex the matter of SRI in the foundation context is and how much legal groundwork lies still ahead. Yet, this groundwork is necessary and promising as it helps to tap the full potential of sustainable investment strategies in the foundation sector.