The 'Prudence' Test for Trustees in Pension Scheme Investment: Just a Shorthand for 'Take Care'

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> 'Investment powers are an example of equitable principles being supplemented by high-level statutory statements of principle which make the law, if anything, more flexible than it was before. I do not think that we need fear such reformulations. After all most of the general statements of equitable principles which we use today are simply a way of putting the matter which occurred to some Victorian judge in the course of an ex tempore judgment which his successors sought sufficiently felicitous to be worth repeating. There is nothing sacred about such formulations and I do not see why Victorian judges should be regarded as having had some special insight into the mot juste which the Australian Parliament or Professor Goode's committee or even modern judges lack. What matters is not the source of the principle but whether the judges are willing to regard it as a principle rather than try to interpret it as a black–letter rule.'
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> *Lord Hoffmann (then Hoffmann LJ) in his 1994 paper 'Equity and its role for superannuation pension schemes in the 1990s'*[1]

This article looks at the duty of care for trustees of an occupational pension scheme in relation to in investment. It is common to refer to a duty of 'prudence' or to be 'prudent' or to be a 'prudent person'.

This article looks at the meaning of prudence in this context and whether it helps in defining the trustee's duty of care in relation to investments. Broadly, this article looks at:

- What does prudence mean?
- What does the investment duty of care require?
- Is it the right test for pension schemes and commercial trusts?

Trustee investment duty

This article primarily looks at the role and duties of the trustee[2] of an occupational pension scheme, in particular at the duty of care applying to the trustee in relation to investment matters.

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1 'Equity and its role for superannuation pension schemes in the 1990s', Ch 5 in M Scott Donald and Lisa Butler Beatty (Eds), *The Evolving role of Trust in Superannuation* (Federation Press, 2017) at p 79.

2 The trustee of an occupational pension scheme is now usually a separate trustee company (rather than individual trustees). The directors of the trustee company are often called 'trustees' but strictly as a legal matter they are not. See further Pollard *The Law of Pension Trusts* (Oxford University Press, 2013) at Chs 4 and 5.

As such this article does not deal with the trustee duties in other areas, such as in relation to the exercise of discretions in relation to benefits or in relation to funding – for example the statutory reference to funding on a prudent basis in the scheme specific funding provisions under Pt 3 of the Pensions Act 2004 (PA 2004).[3]

The discussion in this article applies to investment by the trustees of other trusts as well, for example unit trusts and family wealth trusts. However, as discussed below, one of the important factors (contexts) in relation to the scope and ambit of the duty of care is the nature and purpose of the trust. A family wealth trust, for example, has a materially different purpose to a pension scheme.

Other duties in relation to investment

It is clear that a duty of care – or skill and care – applies to the trustee in relation to its investment powers. This is in addition to and should be considered as separate from the other duties and limits on the investment power. The duty of care and skill is separate from those other duties, although the ambit of those other duties will inform the scope and extent of the duty of care and skill.

Those other duties and constraints are not considered in detail in this article, although they form the context in which the courts will consider the ambit of a duty of care (or prudence). Broadly those other duties and limits are:

(a) **Within powers:** Staying within terms of the trust instrument. The trustee should only invest (or hold investments) which are authorised investments, that is within the terms of the investment power for the pension scheme. In practice it is common for pension scheme trust instruments to include a wide express investment power. Such a wide power is also now implied under s 34 of the Pensions Act 1995 (PA 1995).[4] But this statutory power is subject to any limitation in the trust instrument.[5]

Any other requirements in the trust instrument also need to be complied with (for example if a third-party consent is needed, other than, in the case of an occupational pension scheme, that of an employer[6]).

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3 See for example the Occupational Pension Schemes (Scheme Funding) Regulations 2005 (SI 2005/3377) in relation to the methods and assumptions determined by the trustees (usually in agreement with the employer – see PA 2004, s 229) to be used in the calculation of technical provisions:

- at reg 5(4)(a) – 'economic and actuarial assumptions must be chosen prudently, taking account, if applicable, of an appropriate margin for adverse deviation';
- reg 5(4)(b) – 'rates of interest used to discount future payments of benefits must be chosen prudently …'; and
- reg 5(4)(c) – 'the mortality tables used and the demographic assumptions made must be based on prudent principles …'.

This aspect of prudence in relation to funding was discussed by Jonathan Hilliard QC and Leonard Bowman in their talk 'The virtue of prudence and other funding puzzles' given at the Association of Pension Lawyers (APL) annual conference in November 2019.

4 There can still be issues on the meaning of 'investment' as used in the statutory provision or in the trust instrument. Not all assets or contracts may be investments for this purpose. See, eg the discussion of simple loans in *Re Wragg* [1919] 2 Ch 58; *Khoo Tek Keong v Ch'ng Joo Tuan Neoh* [1934] AC 529, PC; *Dominica Social Security Board v Nature Island Investment Co* [2008] UKPC 19 at [21] and *Dalriada Trustees Ltd v Faulds* [2011] EWHC 3391 (Ch), [2012] 2 All ER 734 (Bean J) at [58] to [64].

5 PA 1995, s 34(1): 'subject to … any restriction imposed by the scheme'.

6 PA 1995, s 35(5).

It is clear that a duty of care remains on trustees, even where there is a wide investment power.[7]

(b) **Act for a proper purpose:** Trustees must exercise the investment power consistent with the purposes of the scheme and the purposes of the power.[8] This can give rise to issues in some cases where trustees may be seen to have mixed motives, for example investing based on political or moral considerations, rather than investment purposes based on financial factors.[9]

(c) **Fiduciary duties**: The trustees should not have an unauthorised conflict of interest or duty.[10]

(d) **Statutory duties and constraints**: These include the requirements (mainly under the Pensions Act 1995) for:

(i) specific requirements under the 2005 Investment Regulations[11] on the exercise of powers of investment including diversification, investment on regulated markets, restrictions on borrowing, etc;
(ii) trustees to produce and review a statement of investment principles (SIP);[12]
(iii) trustees to take advice;[13]
(iv) to consult with the employer;[14]
(v) restrictions or prohibitions on employer-related investment;[15]
(vi) the need to appoint a fund manager (and other advisers);[16] and
(vii) a requirement under the Financial Services and Markets Act 2000 (FSMA), for trustees to be authorised under that Act if they make 'day-to-day' investment decisions

7 Eg *Nestle v National Westminster Bank Plc* [1993] 1 WLR 1260, [1994] 1 All ER 118 CA per Dillon LJ at 126c. Discussed further below.

8 For a comparatively recent example of a pension trustee decision (not on investment) being set aside for not having a proper purpose, see *British Airways Plc v Airways Pension Scheme Trustee Ltd* [2018] EWCA Civ 1533, [2018] Pens LR 19. See generally on proper purposes, Pollard *Pensions, Contracts and Trusts: Legal Issues on Decision Making* (Bloomsbury Professional, 2020), in particular Chapter 30 on investment.

9 For an example of political issues, see *Martin v City of Edinburgh* 1988 SLT 329, [1989] Pens LR 9 and *R (Palestine Solidarity Campaign Ltd) v Secretary of State for Housing, Communities and Local Government* [2020] UKSC 16, [2020] 1 WLR 1774.

On economic social or governance (ESG) issues, the Law Commission reached the view that pension trustees can take into account non-financial factors if 'they have good reason to think that scheme members share the concern and there is no risk of significant financial detriment to the fund': Law Commission of England and Wales Report 'The Fiduciary Duties of Investment Intermediaries' (2014, Law Com No 350) at 6.57 and 6.101, drawing on *Harries v Church Commissioners* [1992] 1 WLR 1241 at 1247 (Sir Donald Nicholls V-C). This issue is discussed in Philip Bennett 'Must an occupational pension scheme take into account ESG factors, even if there is a risk of financial detriment to the pension fund?' (2019) 32 TLI 239. It (or a variant taken from the statutory guidance under consideration) was also mentioned (seemingly without criticism) by the Supreme Court in *R (Palestine Solidarity Campaign Ltd) v Secretary of State for Housing, Communities and Local Government* [2020] UKSC 16, [2020] 1 WLR 1774.

For a US perspective, see Max Matthew Schanzenbach and Robert H Sitkoff, 'Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee' (2020) 72 Stanford Law Review 381.

10 Eg for pension trustees on conflicts, see *Manning v Drexel Burnham Lambert* [1995] 1 WLR 32 (Lindsay J). See further Pollard *The Law of Pension Trusts* (Oxford University Press, 2013) at Ch 6.

11 The Occupational Pension Schemes (Investment) Regulations 2005 (SI 2005/3378) ('Investment Regs 2005'), reg 4.

12 PA 1995, s 35(11). Supplemented by Investment Regs 2005, reg 2(3).

13 Advice on a SIP: in writing and from a person believed to be qualified and to have appropriate knowledge and experience – Investment Regs 2005, reg 2(2)(a). Advice on whether investments are suitable – PA 1995, s 36(3) and (4). The advice usually needs to be from an FSMA-authorised adviser and needs to be given or confirmed in writing – PA 1995, s 36(6) and (7).

14 Investment Regs 2005, reg 2(2)(b). For a case on SIP consultation, see *Pitmans Trustees v The Telecommunications Group* [2004] EWHC 181 (Ch), [2005] OPLR 1.

15 PA 1995, s 40 and Investment Regs 2005, regs 10 to 16. Discussed in Pollard *The Law of Pension Trusts* (Oxford University Press, 2013) at Ch 19.

16 PA 1995, s 47. Mode and terms of appointment are dealt with in the Occupational Pension Schemes (Scheme Administration) Regulations 1996 (SI 1996/1715, as amended).

(subject to some exceptions).[17] Most pension trustees are not FSMA authorised and so in practice delegate day to day decisions to an authorised fund manager.

This list is likely to be joined by obligations in regulations aiming to secure 'effective governance' in relation to the effects of climate change.[18]

Investment duty of care not a fiduciary duty

Any trustee duty of care in relation to an investment function is not in itself a 'peculiarly' fiduciary duty[19] in the strict and limited categorisation of Millett LJ in *Mothew*.[20] Despite this, where exercised by a fiduciary (eg a trustee) the duty of care is still sometimes called a fiduciary duty[21] and even as a non-fiduciary duty its exercise will be subject to the 'peculiarly' fiduciary duties (eg no unauthorised conflicts etc).[22]

Why is the investment duty of care so important?

In current times there is much economic (and physical) turmoil. This may well place strains on an occupational pension scheme, for example a strain on the strength and ability of the employer to support the scheme – called the employer covenant – and also on the level and performance of the scheme's investments.

For occupational pension schemes the trustee has a duty of care – it needs to manage and monitor the investments and (mainly for defined benefit schemes) employer covenant. Clearly there is an increased risk that interested parties – members (and employers and the PPF[23]) – will review pension fund asset performance in retrospect and consider whether the trustee board should have done better. The current turmoil may result in more legal claims against trustees in relation to the investment performance.

There is also the potential for criminal sanctions or civil penalties against trustees in some circumstances. The Pension Schemes Bill 2020, currently before Parliament, will, if enacted, create new widely-drawn criminal offences (and increased penalties) based on acts or omissions in relation to or affecting an occupational pension scheme. These include offences that could fairly easily extend to investment decisions – for example as 'conduct that

17 Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001 (SI 2001/1177, as amended), art 4. The exemptions include the buying or selling of units or rights in certain pooled funds (eg units in collective investment schemes or shares in investment trusts or rights under an insurance policy), provided advice has been received and considered from a relevant adviser (usually FSMA authorised) – art 4(6) and (7).

18 The Pension Schemes Bill 2020, currently before Parliament, will, if enacted, give power to the Secretary of State to make regulations requiring trustees of occupational pension schemes to consider climate change – see new s 41A proposed to be added into PA 1995:

> 'Regulations may impose requirements on the trustees or managers of an occupational pension scheme of a prescribed description with a view to securing that there is effective governance of the scheme with respect to the effects of climate change.'

19 McGhee and Elliott (Eds) *Snell's Equity,* 34th Edn (Sweet & Maxwell, 2019) at 10-042; Law Commission report 'Fiduciary Duties of Investment Intermediaries' (2014, Law Com no 350) at 3.13, citing *Hilton v Barker Booth & Eastwood* [2005] UKHL 8, [2005] 1 WLR 567 at [29].

20 *Bristol and West Building Society v Mothew* [1998] Ch 1, CA per Millett LJ at 17.

21 Eg *Pitt v Holt* [2013] UKSC 26, [2013] 2 AC 108 per Lord Walker at [73] and *Palestine Solidarity Campaign* [2020] UKSC 16 per Lord Carnwath at [44] agreeing with a submission from counsel.

22 This confusion in terminology is discussed in the Law Commission report 'Fiduciary Duties of Investment Intermediaries' (2014, Law Com no 350) at 3.11 to 3.13 and 3.64 (fn127) and Pollard *Pensions, Trusts and Contracts: Legal Issues on Decision Making* (Bloomsbury Professional, 2020) at Ch 62.

23 The board of the Pension Protection Fund, established under PA 2004.

detrimentally affects in a material way the likelihood of scheme benefits being received'.[24] It may be argued to be an offence if a decision was made that resulted in investments being over risky with the result that it risked the likelihood of benefits being received in full. This is discussed further below.

The pension trustee's duty of care in relation to investment is particularly important because:

- the assets of pension schemes can be large – so any claim based on underperformance could involve very large sums; and
- the common exonerations in pension scheme trust instruments (eg that trustees are only liable for a breach of duty if they act fraudulently or knowingly wrongly[25]) are excluded by PA 1995 from applying in relation to investment functions.[26]

What is the investment duty of care for a pension trustee board?

When looking at the legal duty of care and skill on trustees (including pension trustees), commentators (and case law) generally refer to a 'prudent person of business' test, citing two decisions from the 1880s. The first is the 1883 decision in *Speight v Gaunt*:[27]

> 'As a general rule a trustee sufficiently discharges his duty if he takes in managing trust affairs all those precautions which an ordinary prudent man of business would take in managing similar affairs of his own.'

The second is the 1886 decision in *Re Whiteley*[28], in particular the holding by Lindley LJ:

> 'the duty of a trustee is not to take such care only as a prudent man would take if he had only himself to consider; the duty rather is to take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide.'

Implied prudence duty?

These cases are cited by most commentators in relation to trustee investment duties for trusts generally[29] and in the smaller number of commentaries on pension trusts.[30] Prudence is

24 Proposed new PA 2004, s 58B. The 2020 Bill currently envisages further requirements for an act to be a crime, including: (a) that the person knew (or ought to have known) that the relevant act would have that effect; and (b) that the person has no 'reasonable excuse'.

25 For examples in public documents see Pollard *The Law of Pension Trusts* (Oxford University Press, 2013) at 14.11.

26 PA 1995, s 33. Discussed further below.

27 *In re Speight* (1883) 22 ChD 727, CA (Jessel MR, Lindley and Bowen LJJ). Upheld by the House of Lords on appeal: *Speight v Gaunt* (1883) 9 App Cas 1, HL.

28 *In re Whiteley* (1886) 33 ChD 347, CA per Lindley LJ at 355. Upheld by the House of Lords on appeal: *Learoyd v Whiteley* (1887) LR 12 App Cas 727, HL.

29 Eg Tucker, Poidevin and Brightwell (Eds), *Lewin on Trusts,* 20th Edn (Sweet & Maxwell, 2020) at 35-066; Hayton, Matthews and Hilton, *Underhill & Hayton: Law of Trusts and Trustees,* 19th Edn, (LexisNexis, 2017) at [49.57], citing *Cowan v Scargill* [1985] Ch 270 at 289 at 289, which itself cited *In re Whiteley*; Jonathan Hilliard and Emily McKechnie 'Practice Note on Duty of Care for Pension Trustees' (Practical Law); Heydon and Leeming, *Jacob's Law of Trusts in Australia,* 8th Edn, (LexisNexis Butterworths, 2016) at [17-18]; and Guy Newey 'Constraints on the exercise of trustees' powers', Ch 2 in P G Turner (ed) *Equity and Administration* (Cambridge University Press, 2018), at p 49. McGhee and Elliott (Eds) *Snell's Equity,* 34th Edn (Sweet & Maxwell, 2019) mentions the term 'prudence' (eg at [29-003] and [29-007], although in the latter case morphing into 'commercial prudence'), but generally focuses on the reasonableness duty under the Trustee Act 2000.

mentioned in the guidance on investment[31] issued by the Pensions Regulator (TPR) and in its Funding Code of Practice.[32]

Where does a duty of 'prudence' come from?

Chantal Stebbings outlined the history of investment duties in *The Private Trustee in Victorian England*.[33] This discussed the gradual extension of authorised investments (whether by express provision in the trust, or gradually by statute). It also looked at the prudent man of business test applicable to trustees managing investments within the authorised category, commenting that this test (under *Re Whiteley*), 'depended on the economic and investment conditions pertaining at the time'.[34] But later Professor Stebbings noted:[35]

> 'In theory a test founded on the long term conduct of the ordinary prudent man of business, although making long term provision for others was practical, reasonable, realistic and inherently flexible. It had the potential to adapt to current commercial conditions. In practice, however, most people involved in trust administration found that the way it was interpreted by the courts was too demanding, because it was in practice and perception applied in a way far removed from its pragmatic and realistic origins.
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> […] such risks were anathema to the law, and the test became increasingly distorted by the judges as they failed to keep up with business practices.'[36]

As mentioned above, the 1883 decision in *Speight v Gaunt*[37] and the 1886 decision in *Re Whiteley* are usually taken as the current foundation[38] of any prudence duty for trustees (generally, not just pension trustees) in relation to investment matters.[39]

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30 *Freshfields on Corporate Pensions Law 2015* (Bloomsbury Professional, 2015) at Ch 17; CMS Pensions Team, *Pensions Law Handbook,* 14th Edn, (Bloomsbury Professional, 2019) at 10.22; *Tolleys Pensions Law* (loose-leaf, 2018) at Ch G1 (Clifford Sims); John Quarrell 'The law relating to investments' (1994) APL conference; Law Commission report 'Fiduciary Duties of Investment Intermediaries' (2014, Law Com no 350) at 3.13; Stuart O'Brien 'Trustees Fiduciary duties of investment' (APL Conference, Nov 2018).

31 TPR's recent publication (17 March 2020) 'DB scheme funding and investment: COVID-19 guidance for trustees' does not mention prudence. See https://www.thepensionsregulator.gov.uk/en/covid-19-coronavirus-what-you-need-to-consider/db-scheme-funding-and-investment-covid-19-guidance-for-trustees [accessed 1 December 2020].

32 TPR CoP 3 'Funding Defined Benefits' (July 2014) at [94]:

> '94. As fiduciary stewards of scheme assets, trustees have a duty to invest them prudently in accordance with the scheme's provisions and the legislative framework.'

Citing 'section 36 of the Pensions Act 1995 and regulation 4 of the Occupational Pension Schemes (Investment) Regulations 2005 (SI 2005/3378)'.

33 Chantal Stebbings, *The Private Trustee in Victorian England* (Cambridge University Press, 2002) at Ch 5.

On the history of the duty of care, see also M Scott Donald 'Prudence under pressure' (2010) 4 J Eq 44 at 46 to 48; Joshua Getzler 'Duty of Care', Ch 2 in Peter Birks and Arianna Pretto (Eds), *Breach of Trust* (Hart Publishing, 2002) and Joshua Getzler 'Fiduciary investment in the shadow of a financial crisis: was Lord Eldon right?' (2009) 3 J Eq 219.

On the impact of inflation in the Victorian age, see WA Lee 'Modern Portfolio theory and the Investment of Pension Funds', Ch 10 in P D Finn (Ed), *Equity and Commercial Relationships* (Law Book Co, 1987).

34 Stebbings, n 33 above, at p 155.

35 Stebbings, n 33 above, at p 157.

36 A comment echoed by Edelman J in *ASIC v Drake (No 2)* [2016] FCA 1552, discussed below.

37 (1883) 9 App Cas 1, HL (Earl of Selborne LC, Lord Blackburn, Lord Watson and Lord Fitzgerald) per Lord Blackburn at 19.

38 Prudence or being prudent had clearly been applied in earlier cases, see eg *Blue v Marshall* (1735) 24 ER 1110, (1735) 3 P Wms 381 (Lord Talbot LC) at 383 – 'The defendant seems to have done nothing but what was prudent'; *Harden v Parsons* [1758] 1 Eden 145, (1758) 28 ER 639.

Speight v Gaunt

In 1883 in *Speight v Gaunt* the Court of Appeal held that it was the duty of a trustee to conduct the business of the trust with the same care as *an ordinary prudent person*[40] *of business would extend towards his or her own affairs*: *In re Speight*.[41] Sir George Jessel MR held at p 739:

> 'It seems to me that on general principles a trustee ought to conduct the business of the trust in the same manner that an ordinary prudent man of business would conduct his own, and that beyond that there is no liability or obligation on the trustee. In other words, a trustee is not bound because he is a trustee to conduct business in other than the ordinary and usual way in which similar business is conducted by mankind in transactions of their own. It never could be reasonable to make a trustee adopt further and better precautions than an ordinary prudent man of business would adopt, or to conduct the business in any other way.'

Similarly Bowen LJ at p 762:

> '[…] it is clear that a trustee is only bound to conduct the business of the trust in such a way as an ordinary prudent man of business would conduct his own.'

This was affirmed by the House of Lords on appeal in *Speight v Gaunt*.[42] Lord Blackburn held at p 19:

> '[…] as a general rule a trustee sufficiently discharges his duty if he takes in managing trust affairs all those precautions which an ordinary prudent man of business would take in managing similar affairs of his own. There is one exception to this: a trustee must not choose investments other than those which the terms of his trust permit, though they may be such as an ordinary prudent man of business would select for his own money […]'.

Re Whiteley

However in investment matters, in applying this principle three years later in 1886, Lindley LJ[43] in *In re Whiteley*[44] added a gloss that the duty is to take such care as an ordinary prudent person would take if he or she were minded to make an investment *for the benefit of other people for whom he or she felt morally bound to provide*.

In *ASIC v Drake (No 2)* [2016] FCA 1552, Edelman J refers at [264] to 'numerous earlier applications' of a prudent person test before *Speight*, including in *Oriental Commercial Bank v Savin* (1873) LR 16 Eq 203 at 206 and in the US in *Harvard College v Amory* (1830) 26 Mass 446.

39 See eg *Bartlett v Barclays Bank Trust Co Ltd* [1980] Ch 515 per Brightman J at 531B.

40 The judgments in this era, and for an appreciable time after, tend to refer to a 'reasonable man' or a 'prudent man' etc, but there is, of course, no reason to limit the principle to men.

Robert Megarry commented in *Miscellany at Law* (Stevens, 1955) that it is appropriate 'to attribute to insufficiently skilled advocacy the finding of the Court of Appeal that [the reasonable man] has no feminine counterpart at all', citing (the fictitious) *Fardel v Potts* (1935) Herbert's Uncommon Law 1 at 6 'at Common Law a reasonable woman does not exist'.

41 *In re Speight* (1883) 22 ChD 727, CA (Jessel MR, Lindley and Bowen LJJ).

42 (1883) 9 App Cas 1, HL (Earl of Selborne LC, Lord Blackburn, Lord Watson and Lord Fitzgerald) per Lord Blackburn at 19.

43 Lindley LJ had been the third member of the Court of Appeal in *Speight*.

44 (1886) 33 ChD 347, CA per Lindley LJ at 355.

Thus Lindley LJ at p 355:

> '[…] care must be taken not to lose sight of the fact that the business of the trustee, and the business which the ordinary prudent man is supposed to be conducting for himself, is the business of investing money for the benefit of persons who are to enjoy it at some future time, and not for the sole benefit of the person entitled to the present income. The duty of a trustee is not to take such care only as a prudent man would take if he had only himself to consider; *the duty rather is to take such care as an ordinary prudent man*[45] *would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide*. That is the kind of business the ordinary prudent man is supposed to be engaged in; and unless this is borne in mind the standard of a trustee's duty will be fixed too low; lower than it has ever yet been fixed, and lower certainly than the House of Lords or this Court endeavoured to fix it in *Speight v Gaunt*.'

This is a clear (and early) recognition that the purpose of the trust (and the investment power) is a factor in moulding the nature of the relevant duty of care.

This was upheld on appeal in *Learoyd v Whiteley*.[46] Lord Watson added, at p 733:

> 'Business men of ordinary prudence may, and frequently do, select investments which are more or less of a speculative character; but it is the duty of a trustee to confine himself to the class of investments which are permitted by the trust, and likewise to avoid all investments of that class which are attended with hazard.'

But in considering the application of these cases, it is important to keep in mind the usual principles applicable when considering a judgment:

(a) Judgments are not statutes and should not be construed or followed as if they were.[47]
(b) The context of the decisions needs to be considered,[48] in particular that:
    (i) the trusts involved were private wealth trusts, with limited implied authorised investments, and a purpose of protecting capital or balancing life tenants and those entitled in remainder; and

45 Note that the reference here is to the ordinary prudent man – not to the trustee being prudent – see Ruth Goldman 'The Development of the 'prudent man' concept in relation to pension schemes' (2000) 5 Jnl of Pens Management 219 and M Scott Donald 'Prudence under pressure' (2010) 4 J Eq 44 at 46. Presumably the onus is on the person who is the trustee – see eg *Bartlett* on a professional trustee. So in a pension trust, it may be relevant that trustee body is part employer nominated and part member.

46 (1887) 12 App Cas 727, HL.

47 See eg *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378, PC per Lord Nicholls at 386B, *Bridge Trustees Ltd v Houldsworth* [2011] UKSC 42, [2012] 1 All ER 659 per Lord Walker at [59] and *Express Electrical Distributors Limited v Beavis* [2016] EWCA Civ 765 per Sales LJ at [55] and [56]. More colourfully, Munby J in *Beazer Homes Ltd v Stroude* [2005] EWCA Civ 265 at [29] held:

> 'Utterances, even of the demi-gods, are not to be approached as if they were speaking the language of statute.'

48 Lord Steyn in *R v Secretary of State for the Home Dept, ex p Daly* commented in a 'famous phrase' that: 'In law, context is everything.' Lord Nicholls stated (extra judicially) that: '[…] it is always necessary to know the context in which the words were being used' – 'My kingdom for a horse: The meaning of words' (2005) 121 LQR 577 at 579 and 580. Similarly Edelman J in *Rinehart v Hancock Prospecting Pty Ltd* [2019] HCA 13 at [83]: 'No meaningful words, whether in a contract, a statute, a will, a trust, or a conversation, are ever acontextual.'

(ii) *Speight v Gaunt* and *Re Whiteley* are decisions now over 130 years old. The cases were in the Victorian era, a time of limited inflation and less developed financial markets.[49]

Speight and *Whiteley* can both be seen as part of a move at that time (the 1880s) to a greater level of duty of care for trustees than previously.[50] Earlier cases on trustees' duties had indicated that legal review was not possible if trustees acted in 'good faith'.[51] This reference to good faith has continued in some more recent cases,[52] but it may be possible to construe these as using the term 'good faith' in this context as going beyond its core meaning of subjective honesty to include proper purposes and due consideration.[53]

Hoffmann LJ (as he then was) made a telling point on this in his 1994 paper:[54]

> 'Investment powers are an example of equitable principles being supplemented by high-level statutory statements of principle which make the law, if anything, more flexible than it was before. I do not think that we need fear such reformulations.
>
> After all most of the general statements of equitable principles which we use today are simply a way of putting the matter which occurred to some Victorian judge in the course of an ex tempore judgment which his successors sought sufficiently felicitous to be worth repeating.
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> There is nothing sacred about such formulations and I do not see why Victorian judges should be regarded as having had some special insight into the mot juste which the Australian Parliament or Professor Goode's committee or even modern judges lack. What matters is not the source of the principle but whether the judges are willing to regard it as a principle rather than try to interpret it as a black–letter rule.'

Why prudence?

Why does prudence (or prudent) keep featuring as the duty of care (or part of the duty of care) for trustees in relation to investment?

Part of this may be because the words 'prudence' and 'prudent' sound more informative as legal terminology used for a duty of care. They perhaps seem deeper than just saying 'reasonable'.

There are examples of this in everyday life: Gordon Brown (when Chancellor of the Exchequer) liked to be thought of as 'prudent',[55] and companies are named after prudence –

49 Australian courts are readily prepared to point out the implications of seeking rigidly to follow older cases. See eg the trust cases *Kearns v Hill* (1990) 21 NSWLR 107 per Meagher JA at [111] – 'the conditions which existed in England in 1850 are not necessarily the same as those which existed in New South Wales in 1970' – and *Hartigan Nominees Pty Ltd v Rydge* (1992) 29 NSWLR 405 per Kirby P (dissenting) at 413, commenting on *Re Beloved Wilkes Charity* – 'The opinion was expressed 141 years ago in respect of a dispute in rural England about a religious office.'

50 This is not a new point. See Robert Ham QC, 'Trustees' Liability' (1995) 9 TLI 21 at 22: '[…] this is to read too much into the use of the word "prudence" rather than the more familiar "care" in this context. This is just a nineteenth-century formulation of a duty of care.'

51 Eg *Re Beloved Wilkes's Charity* (1851) 3 Mac & G 440, 42 ER 330 (Lord Truro); *Duke of Portland v Topham* (1864) 11 HLC 31; *Gisborne v Gisborne* (1877) 3 App Cas 300, HL.

52 Eg *Re Londonderry's Settlements* [1965] 1 Ch 918, CA; *Whishaw v Stephens; Re Gulbenkian's Settlement Trusts* [1970] AC 508 at 518; *Hartigan Nominees Pty Ltd v Rydge* (1992) 29 NSWLR 405 at 427, 428–429.

53 Pollard, *Pensions, Contracts and Trusts: Legal issues on decision making* (Bloomsbury Professional, 2020) at 3.15.

54 Lord Hoffmann (then Hoffmann LJ) in 1994 in 'Equity and its role for superannuation pension schemes in the 1990s' in M Scott Donald and Lisa Butler Beatty (Eds), *The Evolving Role of Trust in Superannuation* (Federation Press, Sydney, 2017) at p 79.

55 See eg William Keegan, *The Prudence of Mr Gordon Brown* (Wiley, 2004).

eg the Prudential Assurance Company. Even one of the main UK financial services regulators is called the 'Prudential Regulation Authority' (PRA).

Looking further at the issue of prudence and the investment duty of care, this article looks at six facets:

(1) What does the legislation say about prudence?
(2) What does 'prudence' mean? – prudence as a shorthand?
(3) What is a better way of describing the duty of care for investment?
(4) Applying out the duty of care: context, time of decision, professionals.
(5) Test for pension trustees?
(6) Legal claims – process/perversity – applying *Braganza*?

(1) What does the legislation say about prudence?

The legislation in England and Wales contains *no* express statutory investment prudence duty on trustees. The main legislation is the Trustee Act 2000 (TA 2000) (for non-pension trusts) and the Pensions Act 1995 (and the Investment Regs 2005) for trusts of occupational pension schemes.

This is unlike the position in other similar trust jurisdictions, for example Jersey, New Zealand and Australia,[56] where the legislation includes an express reference to 'prudence' or 'prudent', in what looks often to be a direct statutory codification of what was said in *Re Whiteley*.[57]

As mentioned above, the funding regulations made under PA 2004 do refer to 'prudent' actuarial assumptions for funding, but this is not in a direct investment context.[58]

Trustee Act 2000, s 1

'1— The duty of care

(1) Whenever the duty under this subsection applies to a trustee, he must exercise such care and skill as is reasonable in the circumstances, having regard in particular—

(a) to any special knowledge or experience that he has or holds himself out as having, and

(b) if he acts as trustee in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession.

(2) In this Act the duty under subsection (1) is called 'the duty of care'.

For England and Wales, the Trustee Act 2000 (TA 2000) codifies many duties on trustees. It includes in s 1 a duty of care on the basis of a reasonableness duty, ie what is 'reasonable in the circumstances'.

This duty under s 1 applies to investment functions, whether under the 2000 Act or otherwise (TA 2000, Sch 1, para 2). But the s 1 duty does *not* apply to investment functions of trustees of an occupational pension scheme (TA 2000, s 36).

56 See eg the discussion of the Queensland Trusts Act 1973, s 22 in *Australian Securities and Investments Commission v Drake (No 2)* [2016] FCA 1552 (Edelman J) at [324].

57 See eg the discussion of the statutory position by Hoffmann LJ in his 1994 paper 'Equity and its role for superannuation pension schemes in the 1990s' (n 1 above) at p 78 as being unlikely to change the 'well-understood equitable principles'.

58 See text to fn 3 above.

The Trustee Act 2000 followed directly from a report of the Law Commission in 1999. In its report, 'Trustees' powers and duties',[59] the Law Commission commented that this duty was intended to be a flexible default standard:

> '[…] the Law Commission considers that, in formulating the new statutory duty, express regard should be had to the particular skills and position of the trustees, and to the circumstances of the trust.'

Pensions Act 1995, ss 33 to 36

In contrast, just five years earlier, when legislating for pension trusts, Parliament decided not to enact a specific investment duty of care on pension trustees.[60] Instead the Pensions Act 1995 (and the underlying regulations, currently the Investment Regs 2005) contain only a very limited express mention of prudence for investment. Investment process is dealt with in PA 1995, ss 33–36 and 40 (and the regulations), but a general duty of care or duty based on prudence in relation to prudence is not expressly set out. There are various exemptions and modifications for small schemes.[61]

PA 1995, s 33 is headed 'Investment powers: duty of care', but it does not set out a duty. Instead it prohibits any exclusion or restriction of a duty of care 'under any rule of law'.

> **'33 Investment powers: duty of care**
>
> (1) Liability for breach of an obligation under any rule of law to take care or exercise skill in the performance of any investment functions, where the function is exercisable—
>
> (a) by a trustee of a trust scheme[62], or
> (b) by a person to whom the function has been delegated under section 34,
>
> cannot be excluded or restricted by any instrument or agreement.'

Section 33(2) goes on to expand the meaning of excluding or restricting in s 33(1).

Section 33 is not an easy section.[63] Establishing a 'rule of law' in relation to care or skill in the exercise of investment functions is not as simple as looking for a statutory provision.

The Pensions Act 1995 and the Investment Regs 2005 (made under PA 1995, s 36(1)) do contain specific obligations in relation to investment. To repeat the outline already given above:

(a) specific requirements under the 2005 Investment Regulations[64] on the exercise of powers of investment including diversification, investment on regulated markets, restrictions on borrowing etc;
(b) trustees to produce and review of a statement of investment principles (SIP);[65]

59 Law Commission of England and Wales '*Trustees' powers and duties*' (May 1999, Law Com No 260) at 3.24 and 3.25.
60 The Report of the Pension Law Review Committee (Sept 1993, CM 2342), chaired by Professor Roy Goode, had recommended (at 4.9.7) a statutory prudent person provision for investment based on the *Learoyd v Whiteley* and *Bartlett* judgments.
61 See Investment Regs 2005, regs 6 to 9 and 13(12).
62 Defined to mean 'an occupational pension scheme established under a trust' – PA 1995, s124(1). The term 'occupational pension scheme' has the same meaning as in PSA 1993, s1 – PA 1995, s176.
63 See, eg Pollard *The Law of Pension Trusts* (Oxford University Press, 2013) at 14.45 and Fenner Moeran QC 'Trustee exoneration & exemption clauses and pension schemes' (2018) Nugee Lecture.
64 The Occupational Pension Schemes (Investment) Regulations 2005 (SI 2005/3378) ('Investment Regs 2005'), reg 4.
65 PA 1995, s 35(11). Supplemented by Investment Regs 2005, reg 2(3).

(c) trustees to take advice;[66]
(d) to consult with the employer;[67]
(e) restrictions or prohibitions on employer-related investment;[68] and
(f) the need to appoint a fund manager (and other advisers).[69]

This list is likely to be joined by obligations in regulations aiming to secure 'effective governance' in relation to the effects of climate change.[70]

Investment Regs 2005, reg 4

Regulation 4 of the Investment Regs 2005 deals with the exercise of investment powers, with specific obligations on pension trustees (and fund managers). Reg 4 contains a fairly detailed list of express constraints and duties on trustees.

IORP

Regulation 4 aims to enact in the UK the obligation derived from EU law,[71] in particular Art 18 of the IORP Directive.[72] The IORP Directive on pensions was originally put in place in 2003. The key provision on investment is in Art 18.[73]

> **'Article 18: Investment rules**
>
> Member States shall require institutions located in their territories to invest in accordance with the 'prudent person' rule and in particular in accordance with the following rules: […]'.

The IORP is potentially important in the context of a prudence duty in that it expressly refers to a 'prudent person' rule. But this is not expressly reflected in UK national legislation:

(1) IORP is a directive, so it is not directly binding on non-governmental entities. But national law should be interpreted so far as possible to comply, for example *Marleasing.*[74]

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66 Advice on a SIP: in writing and from a person believed to be qualified and to have appropriate knowledge and experience – Investment Regs 2005, reg 2(2)(a). Advice on whether investments are suitable – PA 1995, s 36(3) and (4). The advice usually needs to be from an FSMA authorised adviser and needs to be given or confirmed in writing – PA 1995, s 36(6) and (7).

67 Investment Regs 2005, reg 2(2)(b). For a case on SIP consultation, see *Pitmans Trustees v The Telecommunications Group* [2004] EWHC 181 (Ch), [2005] OPLR 1 (Morritt V-C).

68 PA 1995, s 40 and Investment Regs 2005, regs 10 to 16. Discussed in Pollard *The Law of Pension Trusts* (Oxford University Press, 2013) at Ch 19.

69 PA 1995, s 47. Mode and terms of appointment are dealt with in the Occupational Pension Schemes (Scheme Administration) Regulations 1996 (SI 1996/1715, as amended).

70 The Pension Schemes Bill 2020, currently before Parliament, will, if enacted, give power to the Secretary of State to make regulations requiring trustees of occupational pension schemes to consider climate change – see new s 41A proposed to be added into PA 1995:

> 'Regulations may impose requirements on the trustees or managers of an occupational pension scheme of a prescribed description with a view to securing that there is effective governance of the scheme with respect to the effects of climate change.'

71 Explanatory Note to the Investment Regs 2005, first paragraph.

72 Its full title is 'Directive on the activities and supervision of institutions for occupational retirement provision' (Directive 2003/41/EC).

73 This is now in IORP 2 (2016/2341/EU), Art 19.

74 *Marleasing SA v La Comercial Internacional de Alimentacion SA* (C-106/89) EU:C:1990:395, [1990] ECR I-4135.

(2) The IORP refers to the 'prudent person' rule. But this is not expressly defined further. There is a similar prudent person rule in the Solvency II Directive (2009/138/EC).[75]

In context it seems at least arguable that the 'prudent person' rule in IORP, Art 18 is limited to compliance with the principles described later in the article (diversification, regulated markets etc).

The Court of Appeal in *Palestine Solidarity*[76] perhaps give limited support to that view when it commented that 'the article places obligations on Member States to require institutions to invest in accordance with the prudent person rule as more particularly set out in Article 18(1)'.

LGPS and prudence?

The Local Government Pension Scheme (LGPS) is a statutory pension scheme for local government employees. This is a public service pension scheme, so the IORP will have direct effect. The LGPS Investment Regulations[77] do not use the word 'prudent' (nor does the Public Service Pensions Act 2013). But the Secretary of State's binding 'Guidance'[78] in 2017 does refer to prudence. It states:

> 'In the context of the local government pension scheme, a prudent approach to investment can be described as a duty to discharge statutory responsibilities with care, skill, prudence and diligence.'

This seems a bit circular: 'a prudent approach' means act with prudence (as well as 'care, skill, […] and diligence')?

Exclusion of prudent person duty in Investment Regs was deliberate

Regulation 4 was clearly designed to enact the requirements under the EU directive, the IORP. But, significantly, no general 'prudent person' investment duty was included in the Investment Regs 2005. This was a deliberate decision by the then government. The government response to consultation[79] on the regulations, in October 2005, expressly confirmed that no 'prudent person' principle would be included (emphasis added):

> 'The term "security, quality, liquidity and profitability of the portfolio as a whole" is taken directly from the Directive, where it is used to give expression to the "prudent person principle". *The requirement for "prudence" is already a central feature of trust law and it is not the Government's intention to place a higher duty of care upon trustees than that which*

75 See Charles H R Morris *The Law of Financial Services Groups* (Oxford University Press, 2019).

76 *R (Palestine Solidarity Campaign Ltd) v Secretary of State for Housing, Communities and Local Government* [2018] EWCA Civ 1284, [2019] 1 WLR 37 per Sir Stephen Richards at [35]. This point was not discussed in the subsequent appeal in Supreme Court in *R (Palestine Solidarity Campaign Ltd) v Secretary of State for Housing, Communities and Local Government* [2020] UKSC 16, [2020] 1 WLR 1774.

77 Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (SI 2016/946).

78 Ministry of Housing, Communities and Local Government, 'Local government pension scheme: guidance on preparing and maintaining an investment strategy statement' published 15 September 2016 and last updated 12 July 2017. Available at www.gov.uk/government/publications/local-government-pension-scheme-guidance-on-preparing-and-maintaining-an-investment-strategy-statement [accessed 8 December 2020].

79 For the consultation document and government response, see: https://webarchive.nationalarchives.gov.uk/20060214032048/http://www.dwp.gov.uk/consultations/2005/ [accessed 8 December 2020].

> *already exists*. By requiring that investments are made not only "in a manner calculated to" ensure the security, quality, liquidity and profitability of the portfolio as a whole, but also with regard to the scheme's expected liabilities, the regulations will focus on the matters trustees should consider when making investment decisions, rather than judging them against the outcomes of the overall investment strategy.'

What is the effect of a failure to comply with ss 34 to 36 (or the Investment Regs 2005)?

There is the potential for claims before the Pensions Ombudsman for maladministration or breach of law[80] and breach may be grounds for removal as a trustee by the Pensions Regulator.[81] PA 1995 provides[82] for TPR to be able to impose a civil penalty (PA 1995, s 10) for a breach by a trustee of s 35 (SIP) or s 36 (choosing investments). This means it is at least arguable that because there is an express sanction in the statute, then this means that there is no other remedy, including a claim by (say) a member for breach of statutory duty – see for example the decision of the House of Lords in *Scally*[83] (a pensions case, but involving a different statute).

(2) What does 'prudence' mean?

The Oxford English Dictionary[84] (OED) definition of 'prudence' is that it means being sensible, taking care or caution:

> 'Prudence:
>
> 1. The ability to recognize and follow the most suitable or sensible course of action; good sense in practical or financial affairs; discretion, circumspection, caution.
>
> In early use: the wisdom to see what is virtuous, seen as one of the four cardinal virtues.'

Effectively the term 'prudence' or being 'prudent' refers to taking care and weighing up risks. So it seems it is no different to 'reasonable'. Some cases do refer to 'reasonable and prudent',[85] seemingly implying a difference, but this is not expanded on in the judgments.

The Law Commission commented on this in its joint 1999 report on Trustees' Powers and Duties[86] which led to TA 2000:

> '3.24 Every trustee should be required to exercise such care and skill as is reasonable in the circumstances. However, the level of care and skill which is reasonable may increase

80 Eg *Adams* (March 2009).

81 Under PA 1995, s 3. See, eg TPR determinations re Stephen Ward (Nov 2018) and Organic Insurance Limited Pension Scheme (Feb 2020).

82 See PA 1995, ss 35(6) and 36(8), as substituted.

83 *Scally v Southern Health and Social Services Board* [1992] 1 AC 294, HL. But this may be impacted by the provision in PA 1995, s 117 that the legislation in PA 1995, Part 1 and any relevant regulations override the provisions of the scheme to the extent that they conflict. Note also the Trustee knowledge and understanding (TKU) provisions in PA 2004, ss 247 to 249B. These include a requirement for knowledge and understanding of investment matters – ss 247(4)(b)(ii) and 248(5)(b)(ii).

84 The OED does also refer to an alternative meaning, involving vicars: '4. A gathering or group of vicars. Obsolete. rare.' It is not contended that this applies in this context.

85 Eg *Cocks v Chapman* [1896] 2 Ch D 763, CA at 778, Lopes LJ referring to 'reasonable care, prudence and circumspection'. Cited by Brightman J in *Bartlett v Barclays Bank* [1980] Ch 515 at 532A.

86 Law Commission 'Trustees' powers and duties' (May 1999, Law Com No 260) at 3.24.

> if the trustee has special knowledge or skills, (or holds him or herself out as having such knowledge or skills), or if the trustee is acting in the course of a business or profession.'
>
> '[…] the Law Commission considers that, in formulating the new statutory duty, express regard should be had to the particular skills and position of the trustees, and to the circumstances of the trust.'

The later Law Commission report in 2014 on Fiduciary Duties of Financial Intermediaries[87] commented that there had been a move away from using the language of 'prudence':

> '3.72 There has been a move away from this traditional language of "prudence". In 2000, trustees' duties of care were put on a statutory footing in England & Wales through the Trustee Act 2000 (the 2000 Act). This implemented, with minor changes, the recommendations of the Law Commission and Scottish Law Commission in our 1999 Report on Trustees' Powers and Duties. The Act signalled a move towards "reasonableness" as the relevant standard of conduct.'

Prudence does not mean risk free

Prudence or reasonableness must depend on the context of the trusts, its purposes and objects and the purposes and objects of the relevant investment power. In the investment context, this must depend on identifying the risks that the trustee is being cautious or careful about.[88] Part of the duty of care must be to use care, in using reasonable efforts:

- to identify the relevant risks,
- to consider their likelihood and materiality or impact; and
- to consider what can be done to mitigate or deal with those risks and at what cost.

In relation to identifying the relevant risks (and their materiality) it is, of course, clear that trustees cannot be expected to have complete foresight or understanding. This would be to impose (in retrospect) a test of perfect vision. This leads to the famous comment by Donald Rumsfeld in 2002:[89]

> 'there are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns – the ones we don't know we don't know.'

It is clear that not all risk can be avoided or mitigated. It is difficult to envisage a totally risk-free investment, even from a nominal capital perspective:

- bank deposits – risk of bank and compensation scheme (in the UK the financial services compensation scheme or FSCS) collapse;

87 Law Commission of England and Wales 'Fiduciary Duties of Financial Intermediaries' (July 2014, Law Com No 350) at 3.72.

88 See M Scott Donald 'Prudence under pressure' (2010) 4 J Eq 44 at 47 to 53.

89 On 12 February 2002 Donald Rumsfeld, then the US Secretary of Defense, answered a question at a US Department of Defense news briefing about the lack of evidence linking the government of Iraq with the supply of weapons of mass destruction to terrorist groups. This is also discussed in Scott Donald 'Prudence in extremis' (Nugee Lectures 2020).

- Government gilts – risk of political change and/or government default (hopefully a low risk for the UK?)

For example, a concern about risk of a fall in equities might lead a trustee to seek what it perceives as a safer investment in (say) cash deposited at a bank. But this mitigation is not risk free: even if it preserves the nominal value of the amount, it probably does not deal well with inflation and if deposited in another currency leaves a currency exposure. In addition there remains a risk of bank failure (perhaps mitigated by state compensation funds, but even these have a risk of failure).

It also seems clear that a trustee is not expected to have perfect knowledge, for example to forsee (or anticipate the effect of) all risks. It cannot be part of the duty of care for a trustee to spend a large amount on identifying even small risks, or spend a large amount insuring against small risks, if on balance the cost (or time?) is reasonably considered to outweigh the perceived benefits. This is similar to the problems with implying a duty on trustees (or others) to consider all relevant factors, regardless of relevant resources. For example in *Alcoa of Australia v Frost*,[90] Nettle JA in the Victorian Court of Appeal referred to a trustee not being 'required to do the impossible', nor be 'expected to go on endlessly in pursuit of perfect information in order to make a perfect decision.' There must be (although not mentioned greatly by the courts) a balance struck between risk and cost or reward.[91]

The courts have confirmed that the duty of care (or prudence) does not mean in relation to investment that no risks should be taken. In effect the courts apply a judgment rule – how has the trustee balanced risk with potential reward?

In 1979, in *Bartlett v Barclays Bank Trust Co Ltd*,[92] Brightman J (as he then was) confirmed that trustees could take risks:

> 'That does not mean that the trustee is bound to avoid all risk and in effect act as an insurer of the trust fund'

Brightman J cited Bacon V-C in the 1883 case *In re Godfrey*:[93]

> 'No doubt it is the duty of a trustee, in administering the trusts of a will, to deal with property intrusted into his care exactly as any prudent man would deal with his own property. But the words in which the rule is expressed must not be strained beyond their meaning. Prudent businessmen in their dealings incur risk. That may and must happen in almost all human affairs.'

Brightman J continued:

> 'The distinction is between a prudent degree of risk on the one hand, and hazard on the other. Nor must the court be astute to fix liability upon a trustee who has committed no more than an error of judgment, from which no business man, however prudent, can expect to be immune'

90 *Alcoa of Australia Retirement Plan Pty Ltd v Frost* [2012] VSCA 238, 36 VR 618 per Nettle JA at [60]. See Pollard *Pensions, Contracts and Trusts* (fn 8 above) at Ch 49.

91 Similarly, J D Heydon and M J Leeming, *Jacobs' Law of Trusts in Australia*, 8th Edn (LexisNexis, 2016) at 17.19 discussing that any duty to insure can only apply 'at least where the cost of insurance is not prohibitive'.

92 *Bartlett v Barclays Bank Trust Co Ltd* [1980] Ch 515 (Brightman J) at 531F.

93 *In Re Godfrey* (1883) 23 ChD 483 (Bacon V-C) at 493.

Brightman J also cited Lopes LJ in the 1896 case *In re Chapman*:[94]

> 'A trustee who is honest and reasonably competent is not to be held responsible for a mere error in judgment when the question which he has to consider is whether a security of a class authorized, but depreciated in value, should be retained or realized, provided he acts with reasonable care, prudence, and circumspection.'

Not a retrospective test – skill and judgment at the time

At first instance in *Nestle*,[95] Hoffmann J confirmed that the duty of care needs to be considered at the time of the relevant decisions and not in retrospect. He held:

> '[…] in reviewing the conduct of trustees over a period of more than 60 years, one must be careful not to endow the prudent trustee with prophetic vision or expect him to have ignored the received wisdom of his time'.

Later, Hoffmann LJ made a similar point about timing in his Australian paper[96] in 1994:

> '[…] we have an example of the flexibility of equity and its ability to adapt to new conditions. In a case in 1987 called *Re Wellcome Trust* which concerned a huge charitable trust, I committed himself to the proposition that equities were a safer form of investment than gilt-edged. It is perhaps a pity that I made this statement about six weeks before the October Black Monday on the world stock markets'.

Balance risk against return: Harries v Church Comrs (1991)

In 1991 in *Harries v Church Comrs*[97] involved a claim in relation to the investment policy of a large charitable trust. Sir Donald Nicholls V-C held that the guiding principle for the investment power was for it 'to further the purposes of the trust'. It would normally further this purpose if the investments grew as much as possible. But seeking such growth must be balanced with the relevant risks. Nicholls V-C held that for investment property charity trustees should be 'seeking to obtain […] the maximum return, whether by income or capital growth, which is consistent with commercial prudence'.

Nicholls V-C held (at p 304c):

> 'Second, there is property held by trustees for the purpose of generating money, whether from income or capital growth, with which to further the work of the trust. In other words, property held by trustees as an investment. Where property is so held, prima facie the purposes of the trust will be best served by the trustees seeking to obtain therefrom the maximum return, whether by way of income or capital growth, which is consistent with

94 *In Re Chapman, Cocks v Chapman* [1896] 2 Ch D 763, CA per Lopes LJ at 778. Chapman is cited in Chantal Stebbings *The Private Trustee in Victorian England* (fn 33 above) at 156 as one which 'showed an unusual perception by the judiciary of the effect of economic conditions on trustees and their impact on the already difficult task of trustees …'

95 *Nestle v National Westminster Bank Plc* (1988) 29 June, (1996) 10 TLI 113 (Hoffmann J) at 115.

96 'Equity and its role for superannuation pension schemes in the 1990s', Ch 5 in M Scott Donald and Lisa Butler Beatty (Eds), *The Evolving role of Trust in Superannuation* (Federation Press, 2017) at p 77.

97 *Harries (Bishop of Oxford) v Church Commissioners* [1993] 2 All ER 300 (Nicholls V-C).

> commercial prudence. That is the starting point for all charity trustees when considering the exercise of their investment powers. Most charities need money; and the more of it there is available, the more the trustees can seek to accomplish.'

And later (at p 304e) that:

> 'investments should be made solely on the basis of well-established investment criteria, having taken expert advice where appropriate and having due regard to such matters as the need to diversify, the need to balance income against capital growth and the need to balance risk against return'

Context

It is clear that the context (and purpose) of a trust is relevant to how the investment powers are to be exercised and to the relevant duty of care for trustees. The nature of the trust is clearly relevant to the relevant duty and this must be kept in mind when looking at the judicial decisions.

Most of the reported caselaw on investment duties for trusts involves family wealth trusts. Their context is often different from that of a pension trust (or a commercial trust or charity):

- A different balance between capital and income?
- Seeking to preserve capital value?

In an age of inflation, does a duty of care or prudence mean looking at preserving the real value of capital (ie taking into account inflation)?[98]

Drake: Edelman J discusses issues on prudence

In 2016 in Australia in *ASIC v Drake*,[99] Edelman J (who was later promoted to join the High Court of Australia) reviewed the duty of care for a trustee in the light of the prudence wording used in previous cases. He outlined the history of the duty of care in England, citing *Speight v Gaunt* and *Re Whiteley*.

Edelman J convincingly criticised how the duty of care had been dealt with over the year, commenting that as a 'flexible standard' too much had been read into the caution implicit in the use of 'prudence' in *Re Whiteley*.

Edelman J identified two particular difficulties that can arise with a 'prudent person' test:

(1) it has been applied in an inflexible manner and by adding a 'gloss' based on a need for caution – [267]. Whether an investment is 'incautious' will depend on the context and circumstances – the terms of the trust instrument and the purposes of the trust – [271]; and
(2) it does not distinguish between the degrees of skill required by different types of trustee – [272].

98 See *Nestle* per Hoffmann J at 115; Hoffmann LJ in 1994 article (n 96 above) at 76.
99 *Australian Securities and Investment Commission v Drake (No 2)* [2016] FCA 1552 (Edelman J).

It is useful to set out Edelman J's comments in *ASIC v Drake*[100] in some detail (with emphasis added):

> *'The trustee's equitable duty of care (the "prudent person" test)*
>
> […]
>
> [265] The statement of the test was, and is, intended to be flexible. As Heydon and Leeming observe, the standard "changes with economic conditions and contemporary thinking": Heydon JD and Leeming MJ, Jacobs' Law of Trusts in Australia (8th ed, LexisNexis Butterworths Australia, 2016) 356 [17-18].
>
> [266] However, *there are two difficulties that can arise with the application of the prudent person* test.
>
> [267] The first difficulty is that this flexible test *was often applied in an inflexible manner or by adding glosses such as a need for caution*. Many of the early decisions that considered the test in England, Australia, and the United States placed great importance upon the need for caution in trust investment. For instance, in *Learoyd v Whiteley* (1887) 12 App Cas 727, 733, Lord Watson said:
>
> > "Business men of ordinary prudence may, and frequently do, select investments which are more or less of a speculative character; but it is the duty of a trustee to confine himself to the class of investments which are permitted by the trust, and likewise to avoid all investments of that class which are attended with hazard."
>
> See also *Re Whiteley* (1886) 33 Ch D 347, 356-357 (Lindley LJ).
>
> [268] This approach was appropriate in an era where the trust was almost invariably used as a concept for preservation of the capital of the settlor, rather than as an investment vehicle. But *this requirement for caution is very difficult to apply as a single, undifferentiated test in the context of the use of trusts in an almost infinite variety of businesses and business purposes*. […]
>
> […]
>
> [271] *The short point is that the refrain in the older cases about caution and avoidance of hazard, if read in isolation, suggests a duty which is abstracted from the terms of the trust instrument and the nature of the trust business. But whether an investment is incautious due to its speculative nature, or impermissibly hazardous, may be affected by the terms of the trust instrument. To give a simple example, a trust established for the purposes of speculation, with terms requiring investment in speculative ventures, requires a different assessment of hazard from a trust which requires investment in government bonds*. As Gummow J said in *Breen v Williams* [1996] HCA 57; (1996) 186 CLR 71, 137, describing the obligations of a trustee under a trust instrument to manage a trust business: "the trustee is required *both to observe the terms of the trust* and, in doing so, to exercise the same care as an ordinary, prudent person of business would exercise *in the conduct of that business* were it his or her own" (emphasis added).

100 *ASIC v Drake (No 2)* [2016] FCA 1552 (Edelman J) at [265] to [273].

[272] *A second difficulty with a single prudent person standard of care is that it does not differentiate between the degrees of skill required by different types of trustee*. As ASIC submitted, a more precise approach is that of Finn J in *Australian Securities Commission v AS Nominees Limited* (517–518):

> "The standard of trustee care and caution of which I have been speaking so far does not differentiate between types of trustee. It is of general application. That standard, moreover, was settled a century ago and during a period when trust corporations were not used for the trading and investment purposes that are the commonplace in this country today. There is, in my view, a substantial question now to be answered as to whether a higher standard is not to be exacted from at least corporate or professional trustees (a) which hold themselves out as having a special or particular knowledge, skill and experience, and (b) which, directly or indirectly, invite reliance upon themselves by members of the public in virtue of the knowledge, etc, they appear so to have."
>
> In *Bartlett v Barclays Trust Co Ltd (No 1)* [1980] Ch 515 at 534 Brightman J was prepared to impose such a higher duty of care on a trust corporation:
>
> > "a professional corporate trustee is liable for breach of trust if loss is caused to the trust fund because it neglects to exercise the special care and skill which it professes to have."
>
> […]
>
> If it were in fact necessary for me so to do (which it is not), I would be prepared to apply to the trustee companies in these proceedings a standard of care higher than that of the ordinary prudent businessperson.

[273] With respect, I agree with these observations.'

Reckless prudence?

Being over cautious, can result in underperformance, compared to a reasonably well understood and considered (and even remunerated) risk? Over caution can be described as 'reckless prudence'. Reckless prudence sounds a bit like an oxymoron.[101] Is recklessness the opposite of prudence (or care)? But the point that this makes is that, for trustees and investment, not taking risks can itself be considered in some circumstances not to be prudent/careful?

There is an early example of such an investment risk in the bible in the new testament in the 'parable of the talents'.[102] The employer asked his two servants to each look after a gold coin during his absence. One servant invested the coin and earned a good return. The other was more cautious and buried the coin in the earth for safekeeping. On the employer's return, both servants returned their coins, but the first also returned a further amount. The employer praised the first servant but castigated the second: 'and cast ye the unprofitable servant into outer darkness: there shall be weeping and gnashing of teeth[103]'.

101 Being reckless seems to be the opposite of prudence: 'Trustees should not be reckless with trust money.' per Dillon LJ in *Nestle* [1994] 1 All ER 118 at 126c.

102 Matthew 25:24–30.

103 Not currently remedies used by the Courts or the Pensions Ombudsman. Perhaps the closest is TPR's power to prohibit a person from being a trustee (or a director of a trustee company) – PA 1995, s 3.

Michael O'Higgins (then TPR Chair) in a speech[104] in 2012 made a similar point when discussing trustee powers in relation to fixing employer funding contribution levels:

> 'The best support for a DB pension is a properly funded scheme supported by a strong employer. While we believe contributions should be made where they are affordable, we do not want trustees to be 'recklessly prudent' in the valuation assumptions they make and in their negotiations with employers. There will be occasions when the right thing to do for the employer and the scheme will be to invest in the growth of the sponsoring company rather than making higher pension contributions.'

And later in relation to investment:

> 'The idea of reckless prudence I mentioned earlier also applies to investment strategy. Legislation does not require trustees to only invest in gilts. Those schemes with a strong employer underpinning pension promises may be able to afford to take more risk. Trustees should, of course, ensure they are aware of what the risks are; and that the employer can support these in the long term.
>
> I see no reason why schemes with a strong covenant, and trustees that fully understand the risks, should not continue to invest in the UK economy through the many equity or debt investment vehicles available on the market.'

It seems clear that in some circumstances, not taking a greater level of risk can be considered not to be careful or prudent.

Finally on this there is a colourful comment in the Wikipedia entry on 'Prudence'[105] that if a reluctance to take risks is 'unreasonably extended to into overcautiousness, then this can become the 'vice of cowardice':

> 'In modern English, the word has become increasingly synonymous with cautiousness. In this sense, prudence names a reluctance to take risks, which remains a virtue with respect to unnecessary risks, but, when unreasonably extended into over-cautiousness, can become the vice of cowardice.'

Caution – ie no speculation or hazard?

Given that some degree of risk taking is allowed by the duty of care (indeed can be mandated), how have the courts sought to draw the line as to when an investment decision has strayed into being a breach of the duty of care (or imprudent)?

In practice this must be a fact specific test (albeit objective rather than subjective). The context of the trust and the investment will be relevant. The courts have therefore only been able to give relatively high-level tests,[106] referring to a distinction between investment (on the one hand) and 'speculation' or 'hazard' on the other.

104 Speech at the Professional Pensions Show in October 2012. Text is archived at https://webarchive.nationalarchives.gov.uk/20121030105729/http://www.thepensionsregulator.gov.uk/press/michael-ohiggins-professional-pension-show-2012.aspx [accessed 8 December 2020]. Quoted by Mark Smith at p 27 in his paper 'Lessons learned from the Pensions Regulator' (Nov 2012) at the APL 2012 annual conference.

105 https://en.wikipedia.org/wiki/Prudence [accessed 9 December 2020].

106 See Hoffmann J's comments in *Steel v Wellcome* on a 'high level of abstraction' discussed below (text to fn 116).

In *Learoyd v Whiteley*, Lord Watson considered that investments 'attended with hazard' should be avoided:

> 'it is the duty of a trustee to confine himself to the class of investments which are permitted by the trust, and likewise to avoid all investments of that class which are attended with hazard.'

Nearly a century later in 1979 in *Bartlett v Barclays Trust*,[107] Brightman J cited Lord Watson and commented:

> 'The distinction is between a prudent degree of risk on the one hand, and hazard on the other.'

In Australia in 1952 in *Fouche v Superannuation Fund Board*,[108] the High Court held that the making of a loan by a pension trust was a breach of trust, 'by reason of its inherent nature', citing *Learoyd v Whiteley*.

Caselaw refers to hazard and speculation, but what is the dividing line between an investment that is prudent or careful and one that is hazardous or speculative?. The courts have found this difficult to define. The risk is that the distinction becomes one which is very subjective, in the eye of the beholder:

- I invest
- You save
- He speculates

Comments outside the legal sphere make this point as well. In particular comments about how buying and holding shares quoted on a stock exchange (presumably an investment) differs from gambling (presumably not).

President Theodore Roosevelt said: 'There is no moral difference between gambling at cards or in lotteries or on the race track and gambling in the stock market.'[109]

The economist JM Keynes in 1936 in his book *The General Theory of Employment, Interest and Money*[110] compared investing on a stock exchange as being similar to a casino:

> 'Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done. The measure of success attained by Wall Street, regarded as an institution of which the proper social purpose is to direct new investment into the most profitable channels in terms of future yield, cannot be claimed as one of the outstanding triumphs of laissez-faire capitalism.'

107 *Bartlett v Barclays Bank Trust Co Ltd* [1980] Ch 515 (Brightman J) at 531H. On hazard, see also *Jones v AMP Perpetual Trustee Co NZ Ltd* [1994] 1 NZLR 690, [1995] Pens LR 53 (Thomas J) and *ASC v AS Nominees Ltd* (1995) 63 FCR 504, [1996] Pens LR 297 (Finn J).

108 *Fouche v The Superannuation Fund Board* [1952] HCA 1, (1952) 88 CLR 609 (Dixon CJ, McTiernan and Fullagar JJ) at [20] (p 637).

109 President Theodore Roosevelt 'Message to Congress on Worker's Compensation', 31 January 1908.

110 Keynes (Cambridge University Press, 1936), p 159.

Pension Schemes Bill and investment risk as a crime?

Taking risks in relation to a defined benefit pension scheme is probably about to become more hazardous in itself. The Pension Schemes Bill 2020, currently before Parliament, will, if enacted in its present form, create a new criminal offence by inserting a new PA 2004, s 58B called 'Offence of conduct risking accrued scheme benefits'.

The main element is that a person[111] does an act 'which detrimentally affects in a material way the likelihood of accrued scheme benefits being received'. It would seem that making investment decisions could, in retrospect, have that effect if the investments do not achieve the return hoped for. Or conversely if the decision is too cautious?

It will be the case that other elements need to be proved for there to be an offence, including that the person knew or ought to have known that the act would have that effect (but this may be relatively easy to show in relation to investment decisions).

The main limiting factor for an offence is the third requirement that 'the person did not have a reasonable excuse for engaging in such conduct'. This is framed as an objective factual test (which is likely to be a decision for a jury[112]). In practice a pension trustee will usually be able to show that it was acting on professional advice in relation to investment, and in which case the risk of prosecution (let alone conviction) may well be reduced.

It remains an intriguing example of potential criminalisation of negligent (rather than intentional or reckless[113]) conduct and may well have a sobering effect on trustees (and others, including advisers).

Proposed new section in PA 2004

'58B Offence of conduct risking accrued scheme benefits

(1) […]

(2) A person commits an offence only if—

(a) the person does an act or engages in a course of conduct that detrimentally affects in a material way the likelihood of accrued scheme benefits being received (whether the benefits are to be received as benefits under the scheme or otherwise),

(b) the person knew or ought to have known that the act or course of conduct would have that effect, and

111 The primary offence is not limited to trustees or employers or persons associated with them. In addition, if a body corporate is guilty of the offence, then if the offence was committed with the consent or connivance of, or was attributable to, any neglect on the part of a director, manager, secretary or similar officer, each of them can also be convicted – PA 2004, s 309(1).

112 *R v G* [2009] UKHL 13.

113 Contrast the (then) government's response to green paper (Feb 2019) 'Government Response to the Consultation on Protecting Defined Benefit Pension Schemes – A Stronger Pensions Regulator', which referred to a crime only in relation to wilful or reckless behaviour:

> 'The Government plans to move forward with proposals for new criminal offences for wilful or reckless behaviour in relation to a pension scheme, and for failure to comply with a CN […].' https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/777758/response-protecting-defined-benefit-pension-schemes.pdf [accessed 9 December 2020]

(c) the person did not have a reasonable excuse for engaging in such conduct.

(3) A reference in this section to an act or a course of conduct includes a failure to act.'

Meaning of prudence or prudent

The terms prudent or prudence in this context each sound like a well-defined concept in terms of a legal test. In fact, they are very high level and ill defined. Their application depends greatly on the particular context. The terms are most useful as a shorthand for 'duty of care' or instead of 'reasonably' or 'cautiously'. Perhaps, as a concept, they are best treated as a 'twitter' shortcut.

There are similar multiple meaning problems with other concepts used in trust law, for example, 'best interests', 'good faith', and 'fiduciary duty' – each much used, but often without further explanation.

(3) Reasonableness is a better way of describing the duty of care for investment?

Trustee Act 2000, s 1

Section 1 of the Trustee Act 2000 (already set out above) codified the common law duty of care for trusts other than occupational pension schemes, based on such care and skill as is 'reasonable in the circumstances'. As noted above, in its report, 'Trustees' powers and duties',[114] the Law Commission preferred this formulation to the use of the term 'prudent' or 'prudence', but felt that ultimately this was just a codification of the common law terminology, with little difference between the terms.

Directors: CA 2006 codifying the common law

Six years later, a similar approach can be seen for directors in the 2006 codification of the law in the Companies Act 2006 (CA 2006) relating to the duty of care owed by directors to their company. The test used in CA 2006, s 174 does not refer to 'prudence' but refers to 'reasonable care, skill and diligence of a 'reasonably diligent person'.

'174 Duty to exercise reasonable care, skill and diligence

(1) A director of a company must exercise reasonable care, skill and diligence.

(2) This means the care, skill and diligence that would be exercised by a reasonably diligent person with—

(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and

(b) the general knowledge, skill and experience that the director has.'

114 Law Commission of England and Wales 'Trustees' powers and duties' (May 1999, Law Com No 260) at 3.24 and 3.25.

The Law Commission later commented that the use of 'prudence' reflects traditional language. As mentioned above, in its report in 2014 on Fiduciary Duties of Financial Intermediaries[115] it commented:

> '3.72 There has been a move away from this traditional language of "prudence". In 2000, trustees' duties of care were put on a statutory footing in England & Wales through the Trustee Act 2000 (the 2000 Act). This implemented, with minor changes, the recommendations of the Law Commission and Scottish Law Commission in our 1999 Report on Trustees' Powers and Duties. The Act signalled a move towards "reasonableness" as the relevant standard of conduct.'

(4) Applying the duty of care: context, advice, professionals

How then do the courts apply the duty of care (or prudence) in relation to investment? There are not a huge number of reported cases, whether for pension trustees or trustees generally.

In 1987 in *Steel v Wellcome*,[116] a case on judicial approval for a widening of the investment power, Hoffmann J commented that the duty of care was at a 'very high level of abstraction', but that being more specific (either in legislation or court judgments) will run the disadvantage of trying to apply to all trusts and also dealing with the circumstances at the time of the decision. Hoffmann J held:

> 'The general prudence principles in *Bartlett* and *Whiteley* […] "put the matter at a very high level of abstraction and neither the courts nor the legislature have been content to leave it there"
>
> 'It is inherent in such attempts to express an abstract canon of prudence in more concrete terms that they will suffer from two disadvantages. First, that they will necessarily have to be expressed as general rules applicable to all trusts which therefore cannot discriminate easily between individual circumstances […].
>
> Secondly, the rules will represent what was thought to give effect to the prudence principle at the time when they were enacted or formulated by the courts. With changes in economic circumstances they may cease to give effect to that principle and may indeed contradict it. There is therefore always a tension, increasing as time passes, between the prudence principle and the more concrete rules which have been laid down from time to time.'
>
> M Scott Donald has commented to similar effect:[117]
>
> 'The measure of what is "prudent", "reasonable" or "fair" can flex and evolve in accordance with community expectations and technologies in a way that is not possible for a narrower, more precise formulation.'

115 Law Commission of England and Wales 'Fiduciary Duties of Financial Intermediaries' (July 2014, Law Com No 350) at 3.72.

116 *Steel v Wellcome Custodian Trustees Ltd* [1988] 1 WLR 167 (Hoffmann J).

117 'The Pension Trust: Fit for Purpose?' (2019) 82 MLR 800.

An undemanding standard

Prudence has been held to be an 'undemanding standard'. In *Nestle*,[118] Leggatt LJ held:

> '[…] by the undemanding standard of prudence the bank is not shown to have committed any breach of trust resulting in loss.'

Look at standards at the time

The level of expertise required by the duty of care depends on the standards of the time. In *Nestle*,[119] Dillon LJ referred to the need to consider the duty of care by reference to the 'economic and financial conditions of that time' and commented that too much weight should not be placed on court decisions from the previous century. Dillon LJ held:

> 'Mr Nugee QC for the bank rightly stressed the duty of a trustee to act prudently. The best known formulation of this is in the judgment of Lindley LJ in *Re Whiteley*. […]
>
> 'This principle remains applicable however wide, or even unlimited, the scope of the investment clause in a trust instrument may be. Trustees should not be reckless with trust money. But what the prudent man should do at any time depends on the economic and financial conditions of that time – not on what judges of the past, however eminent, have held to be the prudent course in the conditions of 50 or 100 years before. It has seemed to me that Mr Nugee's submissions placed far too much weight on the actual decisions of the courts in the last century, when investment conditions were very different.'

'Extremely flexible standard'

At first instance in *Nestle*,[120] Hoffmann J, after citing Lindley LJ in *Re Whiteley*, referred to the duty of care (prudence) as being an 'extremely flexible standard' and varying with the times. Hoffmann J held[121]:

> 'This is an extremely flexible standard capable of adaptation to current economic conditions and contemporary understanding of markets and investments. For example, investments which were imprudent in the days of the gold standard may be sound and sensible in times of high inflation. Modern trustees acting within their investment powers are entitled to be judged by the standards of current portfolio theory, which emphasises the risk level of the entire portfolio rather than the risk attaching to each investment taken in isolation.
>
> […]
>
> But in reviewing the conduct of trustees over a period of more than 60 years, one must be careful not to endow the prudent trustee with prophetic vision or expect him to have ignored the received wisdom of his time.'

118 *Nestle v National Westminster Bank Plc* [1994] 1 All ER 118, CA per Leggatt LJ at 142g.
119 *Nestle v National Westminster Bank Plc* [1994] 1 All ER 118 CA per Dillon LJ at 125j and 126c.
120 *Nestle v National Westminster Bank Plc* (1988) 29 June (Hoffmann J), later reported in (1996) 10 TLI 113, [2000] WTLR 795.
121 (1996) 10 TLI 113 at 115.

Context: consider all the circumstances

The duty of care in Trustee Act 2000, s 1 makes express reference to the need to consider the relevant context. It refers to what is 'reasonable in the circumstances'.

The Trustee Act 2000 followed directly from a report of the Law Commission in 1999. In its report, 'Trustees' powers and duties',[122] the Law Commission commented that this duty was intended to be a flexible default standard:

> 'the Law Commission considers that, in formulating the new statutory duty, express regard should be had to the particular skills and position of the trustees, and to the circumstances of the trust.'

This clearly means the context of:

- the trust;
- the times; and
- the trustee.

Advice

Part of the duty of care will mean that trustees are usually expected to obtain and consider proper advice, for example on investment matters.[123] But there may be circumstances where the trustees (or one of them) are sufficiently competent in an area that separate advice is not needed – see for example the family trust case *Daniel v Tee*.[124] Taking advice can help in the trustees meeting their duty of care to take proper account of relevant factors[125].

Similarly the statutory process under TA 2000[126] and, for pension trusts, PA 1995 and the Investment Regs 2005 include requirements for separate advice.[127]

In *Cowan v Scargill*,[128] Megarry V-C cited Lindley LJ in *Re Whiteley* that trustees owed a duty to act prudently, and held:

> 'That duty includes the duty to seek advice on matters which the trustee does not understand, such as the making of investments, and on receiving that advice to act with the same degree of prudence.'

122 Law Commission of England and Wales 'Trustees' powers and duties' (May 1999, Law Com No 260) at 3.24 and 3.25.

123 Eg *Cowan v Scargill* [1985] Ch 270 (Megarry V-C) at 289C: 'the duty to seek advice on matters which the trustee does not understand, such as the making of investments'; *Martin v City of Edinburgh* 1988 SLT 322, [1989] Pens LR 9 (Lord Murray) at 334H; *Nestle v National Westminster Bank Plc* [1994] 1 All ER 118, CA per Dillon LJ at 123j: 'It is inexcusable that the bank took no step at any time to obtain legal advice as to the scope of its power to invest in ordinary shares'; *Harries v Church Comrs* [1993] 2 All ER 300 at 304e: 'having taken expert advice where appropriate'.

124 *Daniel v Tee* [2016] EWHC 1538 (Ch), [2016] 4 WLR 115 (Richard Spearman QC).

125 *Scott v National Trust* [1998] 2 All ER 705 (Robert Walker J) at 717. See Pollard *Pensions, Contracts and Trusts: Legal issues on decision making* (Bloomsbury Professional, 2020) at 42.11 and Ch 47.

126 TA 2000, s 5. Previously, see Trustee Investments Act 1961, s 6(2) and (3).

127 Advice on a SIP: in writing and from a person believed to be qualified and to have appropriate knowledge and experience – Investment Regs 2005, reg 2(2)(a). Advice on whether investments are suitable – PA 1995, s 36(3) and (4).

128 *Cowan v Scargill* [1985] Ch 270 (Megarry V-C) at 289C.

Megarry V-C held that honesty and sincerity are not the same as prudence and reasonableness:

> 'This requirement is not discharged merely by showing that the trustee has acted in good faith and with sincerity. Honesty and sincerity are not the same as prudence and reasonableness. Some of the most sincere people are the most unreasonable; and Mr. Scargill told me that he had met quite a few of them. Accordingly, although a trustee who takes advice on investments is not bound to accept and act on that advice, he is not entitled to reject it merely because he sincerely disagrees with it, unless in addition to being sincere he is acting as an ordinary prudent man would act.'

Portfolio theory/prudent person rule

As noted above, in the 1880s and after, the implied class list of authorised investment was much more restrictive than it is now. In effect, in the 'prudent man of business' test in *Re Whiteley* the courts opted for a very cautious approach looking at each investment on an investment-by-investment basis. However, 130 years later this has changed to a portfolio test, for example the IORP 'prudent person test' as set out in Art 18 of the original IORP and discussed above.

In *Nestle*,[129] Hoffmann J held that

> 'Modern trustees acting within their investment powers are entitled to be judged by the standards of current portfolio theory, which emphasises the risk level of the entire portfolio rather than the risk attaching to each investment taken in isolation.'

The size of the fund being invested is also relevant to the investment duty of care, in particular the use of a portfolio theory.[130]

A similar process applies in the US under American Uniform Prudent Investor Act.[131]

It is noticeable that the reported cases against trustees involving family wealth trust mainly concentrate on the trustee underperforming in their investment role, often because they did not focus more on investment in shares instead of fixed interest or government bonds at times of inflation or significant capital growth. Examples are:

- not having enough equities: *Nestle*,[132] *Re Mulligan;*[133] or
- too many of the wrong sort of equities: *Daniel v Tee.*[134]

129 *Nestle v National Westminster Bank Plc* (1988) 29 June, (1996) 10 TLI 113 (Hoffmann J) at 115. See also Hoffmann LJ in his 1994 paper 'Equity and its role for superannuation pension schemes in the 1990s', (fn 1 above) at p 77. On portfolio theory, see M Scott Donald 'Prudence under pressure' (2010) 4 J Eq 44 at 54 to 56; Paul Ali 'Hedge fund investments and the prudent investor rule' (2003) 17 TLI 74; and Emma Ford 'Trustee investment and modern portfolio theory' (1996) 10 TLI 102.

130 See, eg Lord Nicholls 'Trustees and their broader community: Where Duty Morality and Ethics Converge' (1995) 9 TLI 71 at 76.

131 See, eg John H Langbein 'The Uniform Prudent Investor Act and the Future of Trust Investing' [1996] 81 Iowa L Rev 641 at 646. On the then proposed IORP, Ruth Goldman 'The Development of the "prudent man" concept in relation to pension schemes' (2000) 5 Jnl of Pens Management 219.

132 *Nestle v National Westminster Bank Plc* [1994] 1 All ER 118, CA.

133 *Re Mulligan (Deceased); Hampton v PGG Trust Ltd* [1998] 1 NZLR 481 (Panckhurst J).

134 *Daniel v Tee* [2016] EWHC 1538 (Ch), [2016] 4 WLR 115 (Richard Spearman QC).

Diversification

Considering the impact of diversification is now seen to be part of the duty of care (or prudence). Diversification was mandated as part of the obligations under the Trustee Investments Act 1961 and the later TA 2000 and Investment Regs 2005.[135] However, there is not an absolute duty to diversify – only to consider the merits of diversification. Some pension trusts are in effect not diversified in some respects – for example a trust that is invested mainly with one insurer (or investment trust), even though the underlying economic investments may still be diversified.

Same test as for directors' duties

How do the duties of care on trustees compare with those on directors? This is relevant for two reasons:

(1) to look at the development of the common law duties of care and skill; and
(2) where the trustee is a trust company, to consider the duties of the directors.

Prudence was initially used as the standard for directors as well: see *Overend Gurney*.[136] However, later this reduced to a more subjective 'good faith' standard – *Re City Equitable Fire Insurance*.[137]

Given the entrepreneurial and trade/risk-taking purpose of many (most?) companies, prudence (old style) was seen as too cautious. In more recent times, see, for example, the trio of Australian cases: *Daniel v Anderson*,[138] *ASIC v Drake*,[139] and *ASIC v Cassimatis*.[140] This was reflected in the statutory codification of the duty of care owed by directors in the Companies Act 2006, s 174 (Duty to exercise reasonable care, skill and diligence), set out above

As mentioned above, in *ASIC v Drake*[141] in 2016 Edelman J commented that a test based on prudence was 'difficult to apply as a single test' in modern conditions:

> 'Whether an investment was incautious due to its speculative nature, or impermissibly hazardous, might be affected by the terms of the trust instrument. The requirement to avoid hazardous investments which was appropriate in an era where trusts were almost invariably used for the preservation of capital was difficult to apply as a single test in the context of the use of trusts for an almost infinite variety of businesses and business purposes.'

For trustee companies, it is clear that generally the directors owe the relevant duties to the trustee company, and not direct to the beneficiaries of the trust of which the company is trustee.

A director can be liable in relation to a breach of duty:

- to beneficiaries, if he or she dishonestly assists in a breach of trust by the company; or

135 Trustee Investments Act 1961, s 6(1)(a); TA 2000, s 4(3)(b); Investment Regs 2005, reg 4(7).
136 *The Overend & Gurney Co v Gibb* (1872) LR 5 HL 480 per Lord Hatherley LC at 486-487. Cited in *ASIC v Cassimatis* [2020] FCAFC 52 at [127].
137 *Re City Equitable Fire Insurance Co* [1925] Ch 407 (Romer J). Cited in *ASIC v Cassimatis* [2020] FCAFC 52 at [133].
138 *Daniels v Anderson* (1995) 16 ACSR 607 (NSW CA: Clarke, Sheller and Powell JJA).
139 *ASIC v Drake (No 2)* [2016] FCA 1552 (Edelman J).
140 *Cassimatis v ASIC (No 8)* [2016] FCA 1023, 336 ALR 209 (Edelman J), upheld on appeal [2020] FCAFC 52.
141 *ASIC v Drake (No 2)* [2016] FCA 1552 (Edelman J) at [268].

- to trustee company, if a breach of duty by the director to the company, for example claim by a liquidator (or perhaps by a new trustee) – *HR v JAPT*[142] and *Gregson v HAE.*[143] As to the level of duty, see *Bishopsgate Investment Management*[144] and *ASIC v Cassimatis.*[145]

(5) Test for pension scheme trustees?

Having worked out that referring to a duty of 'prudence' does not give much insight, even for family wealth trusts, where do commercial trusts such as pension schemes fit in?

It would generally be possible for a trust instrument to specify a duty of care for investment matters (rather than an exemption provision, which as discussed above for pension schemes may be over-ridden by PA 1995, s 33) – see the discussion of the difference between exemption and duty framing provisions in *ASIC v Drake*.[146] However, a specific duty of care may well be difficult to frame and seems to be, in the author's experience, unusual.

The caselaw still refers to 'prudence' or 'prudent' – for example *Daniel v Tee*[147] – but most of the reported cases are about private wealth trusts. Some cases are not, for example *Cowan v Scargill*[148] (pension trust) and *Harries v Church Comrs*[149] (charitable trust).

Some caselaw indicates the same duties for pension trusts as for family wealth trusts – see for example *Cowan v Scargill*,[150] where Megarry V-C basically agreed on this point with the plaintiffs, but it does not seem to have been argued on either side that 'prudence' was not a suitable test.

In *Nestle*[151] at first instance, Hoffmann J commented that family trusts have different considerations to unit trusts:

> '[…] the investment considerations in family trusts such as this were different from those in unit trusts. I agree […]'.

Similarly, in *ASIC v Drake*[152] (as already cited above), Edelman J contrasted family trusts with commercial trusts.

In practice it is probably too late to argue that it is inappropriate to refer to a 'prudence duty' for pension trusts, given the decision in *Cowan v Scargill*[153] and the terms of the IORP. However, in context, it seems that prudence just means take reasonable care – taking into account the context of the pension trust.

(6) Legal claims – process/perversity – applying Braganza?

Referring to a duty of care by reference to terms such as 'prudence' and 'prudent', seems to do no more than mean 'careful'. It may historically imply aspects of being 'cautious' as well, but

142 *HR v JAPT* [1997] OPLR 123 (Lindsay J).
143 *Gregson v HAE Trustees Ltd* [2008] EWHC 1006 (Ch), [2008] 2 BCLC 542 (Robert Miles QC). Discussed in Pollard *The Law of Pension Trusts* (Oxford University Press, 2013) at Ch 5.
144 *Bishopsgate Investment Management Ltd v Maxwell (No 2)* [1994] 1 All ER 261, CA.
145 *Cassimatis v ASIC (No 8)* [2016] FCA 1023, 336 ALR 209 (Edelman J), upheld on appeal [2020] FCAFC 52.
146 *ASIC v Drake (No 2)* [2016] FCA 1552 (Edelman J) at [277] to [280], citing Donaldson J in *Kenyon, Sons & Craven Ltd v Baxter Hoare & Co. Ltd* [1971] 1 WLR 519, 522-523.
147 *Daniel v Tee* [2016] EWHC 1538 (Ch), [2016] 4 WLR 115 (Richard Spearman QC).
148 *Cowan v Scargill* [1985] Ch 270 (Megarry V-C).
149 *Harries (Bishop of Oxford) v Church Commissioners* [1993] 2 All ER 300 (Nicholls V-C).
150 *Cowan v Scargill* [1985] Ch 270 (Megarry V-C).
151 *Nestle v National Westminster Bank Plc* (1988) 29 June, (1996) 10 TLI 113 (Hoffmann J) at 116.
152 *ASIC v Drake (No 2)* [2016] FCA 1552 (Edelman J) at [271].
153 *Cowan v Scargill* [1985] Ch 270 (Megarry V-C).

this seems unhelpful. So effectively the duty of care means that the trustee must consider and weigh up the potential risks and rewards.

Assuming the investment is authorised, this looks more like a process test. Did the trustee board:

- follow the statutory process (SIP etc)?
- take reasonable steps to identify the relevant risks and rewards?
- take advice? (statutory requirement)?
- consider the relevant factors set out in legislation (eg liquidity, diversification) or otherwise reasonably considered to be material?

Effectively this involves the trustee acting carefully and weighing up risks, but with an objective outcome element if the ultimate decision was one that no reasonable trustee would have reached (a perversity test).

No reasonable trustee?

In order to bring a claim for a breach of trust it seems clear that often a beneficiary will need to show that the trustee board makes a decision that no reasonable/prudent trustee would make: *Nestle* and *Daniel v Tee*.[154]

The burden of showing that there was not a proper investment rests on the claiming beneficiary: *Shaw v Cates*.[155]

In *Nestle*[156] at first instance Hoffmann J, citing an expert witness, agreed with a description of there being a range of opinions:

> 'The difficulty – perhaps sheer impossibility – of satisfying both [tenant for life and remainderman] is reflected in the fact that there is no such thing as an authentic 'proper balance'; although it will be easy enough to say that a fund is unbalanced in extreme cases there must be a wide band in the middle, so to speak, where there is room for a genuine difference of opinion. An opinion on this subject will reflect the view taken of the present state of the market, the prospects for both fixed-interest stocks and equities in the future and the present and future circumstances of the beneficiaries. Clearly an equation containing so many variables is not going to resolve itself into an inevitable solution.
>
> That is in my judgment the right way to approach the problem.'

In *Nestle*[157] in the Court of Appeal, Staughton LJ held that the claim should be dismissed because beneficiary could not show that the trustee made a decision which 'no prudent trustee would have followed':

> 'However, the misunderstanding of the investment clause and the failure to conduct periodic reviews do not by themselves, whether separately or together, afford Miss Nestle a remedy. They were symptoms of incompetence or idleness – not on the part of National Westminster Bank but of their predecessors; they were not without more breaches of trust.

154 *Daniel v Tee* [2016] EWHC 1538 (Ch), [2016] 4 WLR 115 (Richard Spearman QC).
155 *Shaw v Cates* [1909] 1 Ch 389 (Parker J) at 395.
156 *Nestle v National Westminster Bank Plc* (1988) 29 June, (1996) 10 TLI 113 (Hoffmann J) at 116.
157 *Nestle v National Westminster Bank Plc* [1994] 1 All ER 118, CA per Staughton LJ at 133j.

> Miss Nestle must show that, through one or other or both of those causes, the trustees made decisions which they should not have made or failed to make decisions which they should have made. If that were proved, and if at first sight loss resulted, it would be appropriate to order an inquiry as to the loss suffered by the trust fund.'
>
> 'I am inclined to agree with Professor Briston that there should have been diversification in the 1950s, rather than from 1960 onwards. But I cannot accept that failure to diversify in that decade was a course which no prudent trustee would have followed.'

In 2000 in *Wight v Olswang (No 2)*,[158] Neuberger J equated a claim against a professional trustee as needing to be considered in the same way as a negligence claim – was the decision something that could be reasonably done? Neuberger J held:

> 'whether or not that was something which a trustee, complying with the test laid down by Lord Watson, could reasonably have done'
>
> 'This substantially equates the position of a trustee facing a claim for breach of trust in connection with an investment decision with that of a professional man, such as an accountant or solicitor, facing a claim for professional negligence. In *Saif Ali v Sydney Mitchell & Co* [1980] AC 198 Lord Diplock said this at 218C–D: "Those who hold themselves out as qualified to practise […] professions, although they are not liable for damage caused by what in the event turns out to have been an error of judgment on some matter upon which the opinions of reasonably informed and competent members of the profession might have differed, are nevertheless liable for damage caused by their advice, acts or omissions in the course of their professional work which no member of the profession who was reasonably well-informed and competent would have given or done or omitted to do."'
>
> This was followed in 2016 in *Daniel v Tee*[159] by Richard Spearman QC:
>
> '[163] […] 'such a decision is one which no trustee, complying with the duty to act prudently which is laid down in the authorities, could reasonably have made.'

A Wednesbury/Braganza test

So the investment duty of care (or prudence) looks to be very similar to the well-known two-limb *Wednesbury/Braganza* test:[160]

- process: due consideration of what ought to be considered (relevant factors); and
- outcome: not perverse – 'no reasonable decision maker'.

But with input from a proper purpose test too – aim of investment is to be prudent, not take undue risks?

158 *Wight v Olswang (No 2)* [2000] Lloyd's Rep PN 662 (Neuberger J) at 665. In *Daniel v Tee* [2016] EWHC 1538 (Ch) at [43], Richard Spearman QC pointed out that although the decision of Neuberger J in *Wight v Olswang* was overturned on appeal, the Court of Appeal made no criticism of Neuberger J's 'no reasonable trustee' test.

159 *Daniel v Tee* [2016] EWHC 1538 (Ch), [2016] 4 WLR 115 (Richard Spearman QC).

160 *Associated Picture Houses v Wednesbury* [1948] 1 KB 223, CA and *Braganza v BP Shipping Ltd* [2015] UKSC 17, [2015] 4 All ER 639. See further on this Pollard *Pensions, Trusts and Contracts: Legal Issues on Decision Making* (Bloomsbury Professional, 2020).

The process element is not subjective – it is not enough that the trustee considered that it was acting carefully and considering what it thought were the proper factors. In *Cowan v Scargill*,[161] Megarry V-C commented on this:

> 'This requirement is not discharged merely by showing that the trustee has acted in good faith and with sincerity. Honesty and sincerity are not the same as prudence and reasonableness.'

This has recently been cited by the Supreme Court in *Lehtimäki v Cooper.*[162]

Expert evidence needed for a challenge?

If there is a challenge about a failure to invest properly then the claimant will normally need expert evidence in relation to the alleged failure by the trustee, in particular to establish any loss, by showing what would have been the position had the trustee invested properly[163]. In *Nestle*[164], Leggatt LJ held that expert evidence would be needed to show any loss:

> 'The appellant therefore had to prove that a prudent trustee, knowing of the scope of the bank's investment power and conducting regular reviews, would so have invested the trust funds as to make it worth more than it was worth when the appellant inherited it. That was a matter for expert evidence. In the result, there was evidence which the judge was entitled to accept and did accept that the bank did no less than expected of it up to the death of the testator's widow in 1960.'

Expert evidence may, however, not be needed if the failure is 'glaring and obvious'[165].

Overview on use of 'prudence'

Describing the investment duty of care as involving 'prudence' does not give much (any?) help on the nature of the duty of care. The duty looks the same as the reasonableness test. The duty on trustees is similar to the development of that on company directors.

'Prudence' or 'prudent' gives a mixed message

Use of the term 'prudence' is perhaps fine as a shorthand, but it is necessary to understand this and keep it in mind. A pension trustee needs to consider level of risk and reward in the context of the scheme. This means that it needs to take care. This involves working out the purpose of the investment and the relevant risks (eg inflation, asset return, economic prospects, pandemics etc). The legislation and TPR guidance point toward the need for advice and consultation.

161 *Cowan v Scargill* [1985] Ch 270 (Megarry V-C) at 289.
162 *Lehtimäki v Cooper* [2020] UKSC 33, [2020] 3 WLR 461 per Lord Briggs at [232].
163 Proof of loss or damage is needed to complete a claim: *Nestle v National Westminster Bank Plc* [1994] 1 All ER 118, *Daniel v Tee* [2016] EWHC 1538 (Ch) and *ASIC v Drake (No 2)* [2016] FCA 1552 (Edelman J) at [302] to [312].
164 *Nestle v National Westminster Bank Plc* [1994] 1 All ER 118, CA per Leggatt LJ at 141h. On experts, see M Scott Donald 'Prudence under pressure' (2010) 4 J Eq 44 at 51.
165 Eg *Sharp v Blank* [2019] EWHC 3096 (Ch) (Norris J) at [632].

In practice a pension trustee following the statutory investment processes is unlikely to be in breach of its duty of care (or prudence). The trustee should

- properly instruct advisers about risk level, etc (usually this will emerge from the SIP);
- consider and monitor advice; and
- document reasons for investment strategy.

There remains a potential breach if the investment decision is perverse (no reasonable trustee) or contrary to statutory process. But for a damages claim, the onus of proof is on the claimant to show a loss has resulted.