Responsible Investment

Published by Civil Society Media

May 2022
www.civilsociety.co.uk

Making a real change with your investments

The reasons to invest responsibly continue to build post COP26 and Covid

CharityFinance SUPPLEMENT

Global issues continue to drive responsible investment

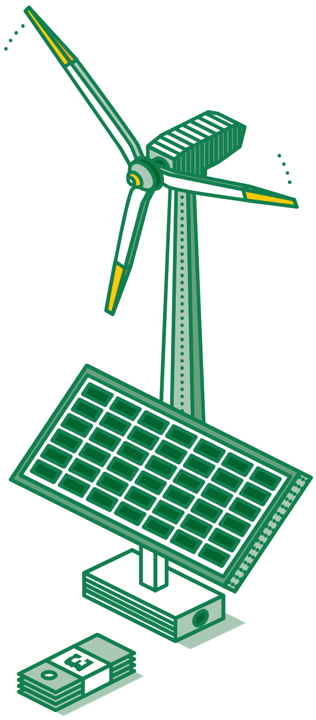
Tristan Blythe reviews events that have impacted the world of responsible investment since last year's supplement

"THE KEY QUESTION ARISING FOR INVESTORS NOW IS WHETHER THE WORLD IS ENTERING A PERIOD OF GEOPOLITICAL DISRUPTION"

Tristan Blythe *is editor of Charity Finance*

RESPONSIBLE INVESTMENT remains an important topic of discussion in the charity sector. In many ways, dire warnings of the need for urgent action on the climate crisis and the legacy of the Covid-19 pandemic have increased the pressure to make sure that investment portfolios are, at the very least, not adding to the problems that society faces and, if possible, actually helping with attempts to solve them.

This pressure is being felt by all types of investors, but is arguably more acute for charities given their role in delivering social good and shaping public perceptions of the sector.



Of course, the sector is diverse and, despite general shared areas, what is suitable as a particular investment for one charity may not be for another. However, being aware of the most prominent topics of discussion and how the responsible investment market is constantly evolving is useful and important for charities with an investment portfolio.

" ESG data providers have been issuing warnings on Russia "

WAR IN UKRAINE

Russia's invasion of Ukraine, if not completely unexpected, was shocking and horrifying. In the face of such events, it is natural to want to do something to help, but easy to feel helpless. That is why donations to help with the humanitarian crisis have flooded in.

As well as this human reaction to the horrors of the war, charities with investments may also be concerned with the broader economic impact of the war. The economic sanctions that many governments, including the UK, US and EU, have put on Russia have started to have some effect.

For responsible investors there was a clear indication that this was something that could affect their portfolio when on 8 March MSCI ESG Research downgraded the ESG Government Rating of Russia from B to CCC, its lowest possible rating. This had quickly followed a downgrade from BBB to B on 28 February.

"Since the downgrade to B on February 28, we have observed further heightening of Russia's 'economic environment' and 'financial governance' risks based on the widening domestic impact of international sanctions and financial isolation on Russia's economy," the company said in a statement.

So, is there anything that responsible investors should or could do to their portfolios in response to the war?

Nathan Fabian, chief responsible investment officer at the Principles for Responsible Investment (PRI), an independent organisation that is supported by the UN, says that it is "easy in hindsight to say that ESG frameworks should include international conflict and retaliatory sanctions as investment risks as a matter of course".

"Some ESG data providers have been issuing warnings on Russia since the annexation of Crimea and again in the weeks before this invasion, especially those focused on controversy monitoring and market sentiment," he writes in a blog on the PRI website. "But equally, political risk and international conflict were not being systematically assessed as priority issues using an ESG lens.

"The key question arising for investors now is whether the world is entering a period of geopolitical disruption and what should be done in terms of managing investment risk in potential hotspots, and ▸ p30

Interview with IAN CHESHAM

Director, Charities Team – Barclays Private Bank

Genuine sustainability requires commitment across your organisation

Although charities, universities and religious organisations have traditionally been at the forefront of driving ethical and responsible investment, more and more environmental, social and governance (ESG) investing is gaining traction across a variety of sectors.

> “In order to drive change and have transition, you need financing”

“There have been many false starts when it comes to responsible investing, but you can see true momentum now,” says director in the charities team at Barclays Private Bank, Ian Chesham. “It will take time to make change happen but you can see how all companies are thinking about it within their own industry, and how they can have a positive effect. It is no longer about just transitioning to more sustainable practices but how to do it the right way – a just transition.”

With momentum driven by a passion within institutions, those financial managers that are not promoting sustainability are getting left behind, says Chesham. “If you’re not serious about responsible investing, you won’t win a client that is also serious about it. It’s one of the first things on a client’s mind.”

This has been accelerated partly by the pandemic and partly by portfolio performance over the last few years, says Chesham. There is also a greater general awareness of the role financial services plays in making change happen. “In order to drive change and have transition, you need financing. How do you get finance companies involved in transforming these businesses? How do you get them to provide lending to companies that do transition? For me that is very powerful because if you put conditions on every type of lending you do, that drives change faster than public pressure. I think using the financial industry to flow capital into these changes is something that is slowly becoming better appreciated.”

ASKING THE RIGHT QUESTIONS

With that awareness comes a responsibility to be informed about how your money is being invested. “Some financial companies see those large inflows of capital in the sustainable space and want to have some exposure, so have a quick product launch to capture that,” says Chesham. “It is important to find out how committed your advisers really are to ESG principles.”

The only way you do that is by asking the right questions. “You need to make sure that the people that advise you are skilled to the level they need to be, and for clients and prospects to have sufficient knowledge to ask the right questions. These could include: have you got a dedicated ESG team? Have you implemented ESG across all of your mandates? Are you providing training support materials to your clients and the wider community? This will help you decide on who should manage your money."

Having a foot in both corporate and private banking gives Barclays insight when it comes to engaging charity clients to help them understand how responsible investing works and what it looks like in practice. "I've presented to many different charities and trustee boards, and explained the processes at whatever level is appropriate to them. So it could be very basic or more complex. There is a lot of material out there. If you want to find out about it, there's enough information available for you to get a good grasp of ESG investing quite quickly."

PRACTICAL SOLUTIONS

Barclays also helps charities address sustainability within their own organisations. Chesham says: "A lot of charities are thinking about how they can cut their carbon footprint themselves? How do they improve their efficiency? This can present real challenges for small under-resourced organisations. They want to make changes but struggle to find the funds."

For example, improving energy usage in an old hospice building can be extremely costly and may not save you money for many years, says Chesham. This can be difficult to justify to donors. To offer a practical solution, Barclays has partnered with Save Money Cut Carbon. "They can provide practical ways to help charities cut their carbon footprints. So we are thinking about how to give clients practical solutions in the same way as we do about investments. Now we can help you cut carbon within your own operations, as well as develop a sustainable investment portfolio. You can't take things in isolation. Even if your investments are sustainable and ESG orientated, you have still got to think about your own challenges, how you can move towards carbon neutrality and what that looks like."

> "There have been many false starts when it comes to responsible investing"

This also helps charities understand the challenges faced by some of the companies in which they invest. Chesham adds: "It is about commitment and getting a greater understanding of what companies do and how they operate, the decisions they are having to make and gaining an appreciation of how far some have already gone."

A fully integrated approach

SAM COTTERELL

Investment Partner – Veritas Investment Partners

Long-term thinking is key to impactful responsible investing

Why doesn't Veritas have a separate ESG strategy?

Environmental, social and governance (ESG) factors are fully integrated into our investment approach. This is true for 100% of our portfolios for charities, corporates and private clients. Our primary goal for all our clients is a financial performance target of beating inflation, over a five-year view, but in reality often much longer.

We believe that ESG risks have the potential to become real financial risks and opportunities for our investee companies in the medium-to-long term. Companies that provide key products or services that enable a shift to a more sustainable world are likely to have a tailwind of growth behind them. Environmental risks are becoming an absolute cost to companies – environmental regulation is rapidly increasing and costs such as carbon taxes are now a reality. As well as responding to stricter regulation, companies need to maintain their social licence to operate, given broader awareness and knowledge from consumers, as well as the ability to attract and retain their workforces. More sustainable practices in terms of social issues can provide real economic benefits, such as lower staff turnover and greater customer loyalty over the mid-to-long term. Not including these risks in our assessment of a company would therefore give us an incomplete analysis.

> “ESG factors are fully integrated into our investment approach”

Why is it so important to be long term?

We have a clear idea of why our clients need to invest. It is to protect their assets against inflation and preserve their wealth for the future. We therefore take a long-term view when it comes to identifying companies for portfolios. We invest in great businesses, with strong and predictable characteristics, that are built to last. These companies offer products and services that will remain in demand for the foreseeable future, regardless of the economic backdrop. We aim to hold shares in companies for at least five years.

Clearly, longer-term holdings also mean our clients pay less in transaction fees. The other major benefit is when considering ESG issues and our stewardship work. ESG issues tend to be long term in nature. Investors who are only interested in the following quarter's results are unlikely to be very engaged with developing a credible net-zero plan or whether a company is working with their supply chain on human rights. We believe in building a relationship with our investee companies, raising material issues with them and being supportive of their efforts to improve in areas we believe demand attention, while recognising that often improvement can be a multi-year process.

What we do

Veritas Investment Partners is an independent investment manager focusing on real returns. Our sole aim is to protect and grow our clients' assets over the long term, over and above inflation, to meet their, and their beneficiaries' needs for the future. We do this by investing in a focused list of great businesses that have strong and predictable characteristics, and that are built to last. Sustainability is included in all parts of our investment process – from initial research of a company to continual monitoring of the companies we hold and engagement with them.

VERITAS
INVESTMENT PARTNERS

FAST FACTS

- Long-term real return investors
- Independent – employee owned
- Partners with our clients, our investee companies and our colleagues
- Research driven, investment led and client centred
- Over £6bn* assets under management, including over £1bn managed on behalf of charities

* As at 31 December 2021

How is your ESG and stewardship work resourced?

We are a small, closely knit team of 22 investment professionals who work in partnership with each other. Given our focused approach, whereby we hold 25-40 companies, we have the capacity to perform in-depth work on each of our companies. For example, over 20% of our company meetings are now focused on ESG issues, although these issues are also often raised in more general meetings. We regard shareholder voting as an important means of communicating with companies and therefore exercise our right to vote on behalf of clients.

The analyst responsible for each company will lead on any engagement work. This means there is one main point of contact for our companies and the analyst can focus on what is material and financially meaningful for each company. This also ensures that ESG considerations and engagement work is fully integrated into our overall thinking and analysis. The analysts are supported in all engagement work by members of the stewardship working group, as well as the broader team where appropriate. The group includes our CIO, and a mix of analysts and portfolio managers. This group focuses on the policies and processes for our stewardship work and on ensuring consistency of practices across the investment team.

We were delighted to be included in the UK Stewardship Code 2021 signatory list.

> “Focus on what is material and financially meaningful for each company”

How is Veritas reflecting sustainability?

Veritas Investment Partners is fully owned by our employees, so we can choose to reflect and constantly improve our own business practices.

We have been certified as carbon neutral* by Natural Capital Partners since 2018, use 100% renewable electricity and our new offices were awarded a gold SKA** rating.

In our supply chain we prefer to use independent, local and fair-trade companies, ensure the London Living Wage is paid, as well as monitor our suppliers' environmental impact.

We are a diverse team, believing that diversity of thought is important for the investment debate. In the investment team, we have 54:46 male:female split, ages span five decades and we have a diverse range of educational backgrounds. We also encourage the future diversity of our industry by working with organisations such as the Sutton Trust, Social Mobility Trust and 10,000 Black Interns to offer work experience and internships.

Our teams take part in fundraising and volunteering activities and the Veritas Charitable Foundation enables efficient donations to our favoured charities.

* Includes Scope 1, 2 and 3 emissions except for portfolio emissions
** SKA is an environmental assessment for non-domestic fit outs run by the Royal Institute of Chartered Surveyors

Glossary

A wealth of jargon has grown around responsible investment. Here are some important terms that are widely used when discussing the topic.

Active ownership: Not just holding an investment for financial reasons, but actively taking an interest in how it operates and trying to be a positive influence on this via engagement (see below).

Best in class: Stocks within sectors that have the best ESG (see below) record. Some responsible investment approaches seek these out rather than exclude a whole sector.

Divestment: The selling of investments due to them failing to meet high enough standards on responsible investment concerns. This often follows a period engagement (see below) with the company that does lead to the desired changes.

Engagement: Being an active shareholder (see above) and engaging with the management of companies in order to improve its actions. This can involve meeting and communicating with management, as well as attending AGMs and voting.

ESG: ESG stands for environment, social and governance. In terms of investment, it means taking these factors into account when selecting what investments to make, rather than basing this on financial factors only.

Exclusion: The deliberate avoidance of investing in certain stocks or sectors due to their negative ESG (see above) actions. The sectors most commonly excluded are sometimes referred to as "sin stocks" (see below).

Greenwashing: The mislabelling of investment offerings as responsible, ethical or environmental when they do not take these factors into consideration.

Impact investing: Making investments that not only seek to avoid doing any harm, but that are actively solving an issue, often an environmental or social issue.

Net-zero: Net-zero is defined by the United Nations as "cutting greenhouse gas emissions to as close to zero as possible, with any remaining emissions re-absorbed from the atmosphere, by oceans and forests for instance".

PRI: The Principles for Responsible Investment is a United Nations-backed programme. It has six principles designed to help incorporate ESG (see above) decisions into investment practice.

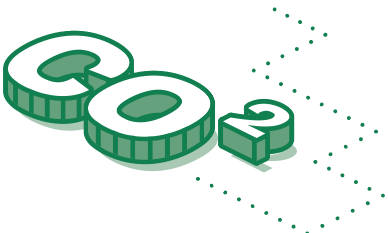
Sin stocks: The sectors that are most commonly excluded in a responsible investment policy. These usually include the tobacco, armaments, pornography, gambling and alcohol industries.

separately whether these might lead to wider regional or global conflicts.

"If ESG is to be the framework used for assessing these non-financial risks, then a wider and systematic scrutiny of potential ESG drivers and consequences of conflict is likely to be needed."

However, Fabian recognises that some of the usual tools used by responsible investors are not applicable in this case.

"The scope for stewardship activities with Russian corporations are clearly limited, as is the influence of these companies on their current government. Direct policy outreach to an aggressive authoritarian government is unlikely to bring an immediate result either. Under these circumstances, investors may be forced into more definitive positions on their one remaining lever, to change their risk weightings and withdraw or withhold investments. If done at scale and collaboratively, this can be powerful."



> "Investors may be forced into more definitive positions"

He adds that while "conflict between nations is not under the direct influence of investors", there is still a number of areas they can act on as a result of the war, including energy policy, human rights, corruption and global governance.

Fabian says that the "severe impact" of the war will push it to the top of investors' human rights concerns.

"Whether investors are connected via sovereign debt holdings, or exposure to companies with operations or links to the territories now affected, they now will be expected to conduct due diligence with heightened attention to magnified risk and social impacts. Given the constantly changing landscape of impacts, investors may complement company information using analysis from the UN, civil society, and human rights organisations delivering insights from the ground."

In terms of energy and climate policy, Fabian highlights the immediate focus on reducing reliance on imported natural gas. This is likely to require "the utilisation of all available energy resources". "Yet, in the mid-to-longer run, the national security co-benefits of the shift towards net-zero are powerful new drivers for accelerating this transition," he adds.

Fabian says that weak governance, lack of transparency, corruption, and allowing money to be cycled through financial capitals without sufficient controls are "potential contributing factors to this conflict" as they "all facilitate abuse of power which can fuel disputes and the decline of democratic institutions".

"Responsible investors have a key role to play in the fight against corruption. They can seek to reinforce international norms such as the United Nations Convention against Corruption and align with frameworks including the UN Global Compact 10th Principle and the International Corporate Governance Network Guidance. They can also be prominent voices in global efforts to tackle illicit financial flows and secrecy jurisdictions, including the lack of beneficial ownership transparency."

In order to help navigate the responsible investment issues surrounding the war, Fabian suggests a decision-making hierarchy:

- "What do my clients, beneficiaries or stakeholders expect of me in countries that use force against the territorial integrity or political independence of another state?
- Could my investments exacerbate conflicts directly or indirectly?
- Should I avoid future investments that may support aggressive authoritarian governments?
- Which ESG consequences arising from the conflict should I assess, prioritise and respond to (including human rights, climate and energy, maintaining global governance and institutions)?
- Will I need to make changes to my investment approach to maintain my sustainability commitments?"

> "It's now or never, if we want to limit global warming to 1.5°C"

While it is impossible not to be moved and concerned by the tragic events in Ukraine, it is just one of many factors that responsible investors have to react to and consider.

THE ENVIRONMENT

One of the other most pressing issues facing responsible investors (and the entirety of humanity) is climate change and protecting the environment.

If there was still any doubt on the need for urgent action, the latest Intergovernmental Panel on Climate Change (IPCC) report published last month gave a stark warning. "It's now or never, if we want to limit global warming to 1.5°C; without immediate and deep emissions reductions across all sectors, it will be impossible," says Jim Skea, co-chair of IPCC Working Group III, which released the report.

Climate Action 100+ (CA100+), an investor engagement initiative on climate change, recently found some corporate climate progress against key climate indicators, but said much more action is urgently needed from the 116 companies it looked at to support global efforts to limit temperature rise to 1.5°C.

The organisation's latest Net Zero Company Benchmark assessed 166 companies and found year-on-year improvements on cutting greenhouse gas emissions, improving climate governance and strengthening climate-related financial disclosures.

However, CA100+ warns that "it is alarming that the vast majority of companies have not set medium-term emissions reduction targets ▶ p36

Charities and net-zero

Charities adopting a responsible investment approach will undoubtedly have a focus on the environmental plans of the companies that they invest in.

This should go hand-in-hand with activities to limit their own environmental impact, but a survey conducted by Charity Finance Group (CFG) suggests that they could be doing more.

Some 84% of charities surveyed by CFG in October 2021 said that they do not yet have a net-zero objective and only 14% said they currently report on their carbon emissions.

When asked about the challenges of moving towards net-zero, respondents cited the following:

- Difficulty understanding the practical changes that could be made.
- The cost of changes, particularly when it comes to property.
- Linking a net-zero strategy to charitable objectives.
- Communicating the need for a net-zero strategy to stakeholders, in particular funders and beneficiaries.
- Accessibility of relevant case studies and best practice examples.

The good news is that more than one third of charities (37%) have had discussions with their trustees about net-zero and climate change.

It seems likely that the direction of travel is that more charities will implement net-zero strategies, both as organisations and as investors.

One charity that has announced steps in this direction is Wellcome which in July 2021 announced a net-zero strategy for its £29bn investment portfolio. The plan is designed to make the portfolio carbon neutral by 2050 at the latest (see page 63).

According to a statement from the foundation it is "encouraging the managers and companies in which it invests to follow Task Force on Climate-related Financial Disclosures recommendations, the global standard for climate related disclosure". It is also joined the Institutional Investors Group on Climate Change to "assist with its engagement efforts and encourage the development of quality emissions reporting standards".

Interview with NICOLA TOYER

Head of Charities – Investec

Responsible investing is about managing ESG issues and effective stewardship

Over recent years, climate change has been pushed up the public agenda as the planet faces unprecedented warming. For investors trying to drive change, it is a complex challenge . "To find a solution to the problems facing the world from a climate change perspective, we are all going to have to pull together in the same direction," says head of charities at Investec Nicola Toyer. "But different economies and countries are at very different stages of their journey towards net-zero."

> " To effect real change, there has to be meaningful engagement "

For Toyer, this highlights the balancing act inherent in the "E" in ESG (environment, social and governance) investing. "There have been a lot of companies and governments signing up to agreements and commitments but there is very little evidencing of what they are actually doing. There is a lot of talking and very little tangible action. This, coupled with the stark difference between the reliance on fossil fuels of developing and developed nations, shows how challenging change is going to be."

This is also a pressing concern of charity investors and one that Investec discusses in detail with its clients. "These are probably the type of questions we get asked the most: how do you consider the environment with the investment? And what are we doing about fossil fuels?"

Finding an answer to these questions is not going to be straightforward. To effect real change, there is going to have to be meaningful engagement at many levels, says Toyer. "I believe that we can't just divest from all fossil fuels. Essentially, if you do that you're passing the problem on to somebody else. What's going to be the impact on the people who live in developing countries that are reliant on coal? Their jobs? Way of life? Even powering their homes? There is social impact of environmental decisions and some of those outcomes can conflict with charities' values. We want to educate charities as to what the impact of their decision-making will be. Ultimately, it's their decision, but you have to think about what responsible investment actually means."

ENGAGEMENT WITH COMPANIES

For Toyer, it comes down to stewardship and leveraging the power of being a stakeholder. "How we engage those companies and being active investors on behalf of our clients is key. If you decide you are not going to invest in fossil fuels, who will be putting pressure on companies

What we do

At Investec, our Charities Investment Service underpins our corporate purpose to create enduring worth, living in society, not off it. We are responsible for preserving and growing the wealth that is entrusted to us by over 1,100 charities; supporting them in delivering their mission. Sustainability is core to our investment approach and we will aim to deliver your financial goals, while ensuring your values are protected. We will take the time to understand your charity and can provide local charity specialists through our 14 regional offices across the UK.

FAST FACTS

- Over £3.5bn in charitable AUM and £43bn of total assets*
- Top 10 manager of UK charities, with over 80 years experience
- Donated £10m to projects and 9,468 staff volunteering hours in 2021
- Investec Beyond Business: created 53 social enterprises, with over 350 jobs
- UN PRI and UK Stewardship Code signatory

* As at 31 March 2022

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to effect change from a shareholder point of view? It is important that clients understand there's also an impact when they choose not to invest."

Investec recognises that some industries are not viable options for investment, both from an ethical and financial standpoint, says Toyer. "There are companies we won't invest in, such as energy companies that aren't committed to the Paris Climate Agreement or show no progress on achieving those targets. We look at the investment cases and the sustainability angle over the long term. Thermal coal for example is not a sustainable business because it's a big polluter and the financial return is just not viable."

As a group, Investec has aligned its goals with UN Sustainable Development Goals (SDGs), and specifically prioritised two core SDGs: one being SDG 13 Climate action; and the other SDG10 – reduced inequalities. Toyer adds: "Our overarching purpose is creating enduring worth, living in, not off society. This purpose is at the heart of everything we do and is at the core of our decision making as a business."

ENGAGEMENT WITH CHARITIES

As the issues around ESG investing become more nuanced, so do the conversations with clients. "There are lots of different moving parts that have raised awareness of ESG issues over recent years and that naturally has led to investors looking at what they can do with their own investments," says Toyer. "They want to understand how we can report on ESG issues within their own portfolios."

This is true of all clients but with charities, it has come to the fore over recent years, adds Toyer. "Trustees are more professional in what they expect from investment managers. They want investing to be aligned with their values."

> "Funds that have an ESG label have done phenomenally"

This is partly due to public scrutiny, suggests Toyer, with the rise of social media and risks of reputational damage constantly only a post away. "There are a whole host of factors that have led to why ESG investment has gained more prominence and changed the conversation with investors. And funds that have a sustainable or ESG label have done phenomenally well. My view is that investments shouldn't actually need the ESG label as assessing ESG factors is primarily about risk management and how this might impact the financial return of a business – for example managing the risks of climate change or human rights abuses. It is about how companies are incorporating sustainability within their businesses; leaving a positive footprint and not a negative one."

The rise of 'S' in ESG

SOPHIE WARD
Head of Charities & Education – HSBC Private Banking

With stark inequalities in focus, charities can seek solutions with engagement

How did Covid-19 impact ESG considerations?

During the pandemic, we saw a range of stark inequalities highlighted around the world. Inequitable healthcare came to the fore, the Black Lives Matter movement focused attention on racial inequality, and we have become much more aware of social issues such as nutrition, education and access to water.

Investors want to understand how these are being addressed in portfolios and how asset managers engage with portfolio companies on these topics, as well as how they can begin to contribute to solutions. For example, at HSBC we have themes such as access to healthcare – and our clients and prospects want to know how you can improve healthcare access through more equitable pricing and digital capabilities. They don't want surface-level knowledge; they want to get under the skin of these problems.

We are now also seeing a greater concern about climate impact from a financial perspective, owing to the fact that climate change is the number one long-term fiduciary risk in investments. For our charity clients, we start by looking at this through a lens of voting and engagement to try and change corporate behaviour, and through tilting portfolios to reduce overall carbon emissions. We then work with them on climate solutions, through green bonds and green structured products.

> "We are also seeing a greater concern about climate impact"

What emerging trends are you seeing?

Covid fanned the flames of many existing sustainable investment trends. Early in the crisis, many people were concerned that sustainable investment would fall by the wayside, but the pandemic served as a proof point, as investors increasingly began to think about the purpose of their wealth.

There are two kinds of responsible investment. The first is investing sustainably in order to achieve positive real-world outcomes. The second incorporates sustainability into decision-making in order to generate superior risk-adjusted returns. We are seeing that charitable investors have shifted away from a focus on ethical investment – essentially negative screening – to focus on both of these fiduciary and impact strands. In fact, research carried out by of HSBC Asset Management found that almost half (46%) of those surveyed in the UK, Hong Kong, mainland China and Singapore believe their portfolios will be entirely made up of sustainable investments in the next three to five years.

The pandemic very much highlighted the need for enhanced diversity and inclusion, as well as social responsibility in local communities. We think this will result in a stronger focus on the "S" in environmental, social and governance (ESG), and so our investment themes include looking at how companies integrate diversity and inclusion in their workforce, and on solutions to broader social issues.

What we do

HSBC Private Banking manages £310bn of investment assets globally and £13.2bn in UK, including £800m for UK Charities. We work with charities, schools and universities on their investment management, providing multi-asset and single asset class discretionary portfolios which can encompass the organisation's ethical and sustainable investment requirements. Additionally, we provide liquidity lending, using portfolios as collateral to allow organisations flexibility with their balance sheets. We provide investment education and cashflow planning, which enables our clients to understand the long-term impact of drawing funds from portfolios. This is in addition to support with writing investment policies and access to thought provoking investment and charity-specific events, as well as industry-leading knowledge from the broader HSBC network.

HSBC
Global Private Banking

FAST FACTS

- £22bn of sustainable investment managed by HSBC Asset Management*
- Improved MSCI ESG rating to AA ('ESG leader') 2021
- World's Best Bank for Sustainable Finance (Euromoney 2019, 2020)
- Award winning Climate Change Centre of Excellence at HSBC Global Research

* As at 31 December 2021

What impact did COP26 have on the 'E' element?

COP26 really brought environmental aspects into the public domain, which is fantastic. We saw a lot of really big pledges, and biodiversity and natural capital gained prominence. Natural capital is, in its simplest terms, the assets of nature. This includes the land and sea, along with the biodiversity of ecosystems within them. Biodiversity is vital for maintaining natural cycles of weather, the food chain and life on earth. As we see natural capital being destroyed, we are witnessing negative consequences such as climate change, biodiversity collapse, local temperature rises, soil loss and the spread of diseases.

As an asset class, natural capital provides exposure to projects focused on nature including sustainable forestry, regenerative and sustainable agriculture, blue carbon (carbon captured by oceans and coastal ecosystems), or nature-based projects that generate returns from reducing greenhouse emissions. COP26 saw pledges around stopping and reversing deforestation by 2030 by over 100 world leaders and more than 30 financial firms. These in turn create new types of investment. For example, HSBC Asset Management has a joint venture with Pollination to create Climate Asset Management, which will rejuvenate land to increase biodiversity and carbon capture.

> “It's key for charities to understand what they want”

What do charities need to consider in the new era?

Firstly, it's key for charities to understand what they want from this space. If they are long-term investors, are they coming at climate change from a fiduciary perspective? Or are they looking to fully align portfolios with their charitable objectives and focus on specific impact areas? Because these could produce two very different outcomes in terms of what a portfolio could look like. This means that charities need to dig deep and ascertain the reasons that they want to invest in this way.

This links to the fact that, with a sustainable portfolio, you might see different short-term market performance. Our research shows that in the long term, sustainable portfolios should align with standard market performance, but investors should be mindful of the fact there might be a shorter-term differential. We've seen this particularly with energy stocks, which some investors choose to exclude on a climate basis, but which have performed very strongly since the lows of 2020.

Please remember that for investments capital is at risk.

aligned with 1.5°C or fully aligned their future capital expenditures with the goals of the Paris Agreement, despite the increase in net-zero commitments".

It found that 17% of companies in the benchmark have set medium-term targets which are aligned with the IEA's 1.5°C scenario and cover all material emissions. Less than half, 42%, have comprehensive net-zero by 2050 or sooner commitments.

Also, it found there is a failure to integrate climate risk into accounting and audit practices. "No company has demonstrated that its financial statements are drawn up using assumptions consistent with net-zero by 2050, as per a new indicator on climate accounting and audit assessed by Carbon Tracker Initiative and Climate Accounting Project," CA100+ says.

Stephanie Maier, global head of sustainable and impact investment at GAM Investments and chair of the global CA 100+ steering committee, says: "Overall the Net Zero Company Benchmark clearly shows that focus companies are not making the progress required to align with achieving the 1.5°C climate goal agreed in Paris and reaffirmed in Glasgow last year. Given that these companies represent the world's largest corporate greenhouse gas emitters, their ambition and pace of change is critical to a successful transition and needs to accelerate.

> "Expect a ratcheting of investor-led shareholder resolutions"

The latest IPCC report starkly outlined the social and economic imperative for this. As a consequence, we should expect a ratcheting of investor-led shareholder resolutions as well as increased scrutiny on transition plans brought to the vote, starting with the imminent AGM season."

THE GOVERNMENT AND THE FINANCIAL REGULATOR

While it is important for companies, charities and other organisations to take action on climate goals as quickly as possible, governments have to play a role as well. In November 2021 the UK hosted the 26th UN Climate Change Conference of the Parties (COP26) in Glasgow.

However, many found the COP26 agreement deeply disappointing and it was criticised by environmentalists and charities for not going far

The FCA's suggested definitions and criteria

The Financial Conduct Authority's (FCA) discussion paper outlines the proposed definitions and minimum criteria for a labelling system for investments

1. **Sustainable** – products that pursue specific sustainability characteristics, themes or objectives alongside delivering a financial return. Divided into three types of product:

a. Sustainable – **Impact** – Products with the objective of delivering net positive and/or environmental impact alongside a financial return. *Minimum criteria:* Intentionality, theoretical ability to deliver and measure additionality through investment decision-making and investor stewardship, impact measurement and verification.

b. Sustainable – Aligned – Products with sustainability characteristics, themes or objectives and a high proportion of underlying assets (measured according to a minimum threshold) that meet the sustainability criteria set out in the UK Green Taxonomy (or could otherwise be verifiably established to be sustainable, where a taxonomy is not yet available). *Minimum criteria:* See Transitioning criteria below, with the addition of minimum thresholds for asset allocation.

c. Sustainable – Transitioning – Products with sustainability characteristics, themes or objectives that do not yet have a high proportion of underlying assets meeting the sustainability criteria set out in the UK Green Taxonomy (or can otherwise be verifiably established to be sustainable, where a taxonomy is not yet available). These products pursue strategies that aim to influence underlying assets towards meeting sustainability criteria over time, for instance through active and targeted investor stewardship. The expectation, therefore, is that this proportion will rise over time. *Minimum criteria:* Evidence of sustainability characteristics, themes or objectives that are reflected fairly and consistently in the investment policy or strategy and may include some combination of:

- Restrictions to the investible universe, including investment limits and thresholds screening criteria (positive or negative).
- The application of benchmarks or indices and expected or typical tracking error relative to the benchmark.
- The entity's stewardship approach as applied to the product.

2. **Responsible** – Impact of material sustainability factors on financial risk and return considered to better manage both risks and opportunities and deliver long-term, sustainable returns. No specific sustainability goals.

Minimum criteria: ESG integration, evidence of ESG analytical organisational capabilities and resources, demonstrable stewardship.

3. **Not promoted as sustainable** – Sustainability risks have not been integrated into investment decisions. No specific sustainability goals.

enough to tackle the climate crisis.

Despite this poor outcome, it is widely expected that many governments will increase regulation on environmental issues – and there are some early signs that this is the case.

In October 2021, in the run-up to hosting the COP26, the UK government published Greening Finance: A Roadmap to Sustainable Investing, its plan to meet its "long-term ambition to green the financial system and align it with the UK's world-leading net-zero commitment".

This sits alongside the forthcoming UK Green Taxonomy which is designed to be "a common framework setting the bar for investments that can be defined as environmentally sustainable".

The government says there are three phases to meeting its long-term ambition:

1. Informing – ensuring decision-useful information on sustainability is available to financial market decision-makers.
2. Acting – mainstreaming this information into business and financial decisions.
3. Shifting – financial flows across the economy shifting to align with a net-zero and nature-positive economy.

The published roadmap covers the first phase, which "will be delivered through new economy-wide sustainability disclosure requirements". Some of the plans will impact on the investment market and the responsible investment market in particular.

For example, the government says "investment products, financial services firms, and real economy corporates will be required to report consistent information on sustainability" and that "asset managers, asset owners and investment products will be required to substantiate sustainability claims they make".

It also says that "investment products will need to set out consumer-focused disclosures showing the impact, risks and opportunities of the activities they finance on sustainability".

This is to be accompanied by a new labelling system being developed by the Financial Conduct Authority (FCA), the regulator of the financial services sector.

In late 2021 to early 2022, the FCA consulted on a discussion paper that outlined the plans for these consumer-facing labels. The FCA is proposing five labels, namely:

- Not promoted as sustainable.
- Responsible – may have some sustainable investments.
- Transitioning – sustainable characteristics, themes or objectives; low allocation to taxonomy-aligned sustainable activities.
- Aligned – sustainable characteristics, themes or objectives; high allocation to taxonomy-aligned sustainable activities.
- Impact – objective of delivering positive environmental or social impact.

Each of these labels would have minimum entry criteria to ensure they are fairly applied (see page 36).

> "The court's decision may affect the draft guidance"

The consultation has closed and was designed to help the FCA to develop new rules which are expected to be published during the second quarter of this year.

THE CHARITY COMMISSION

While the FCA is an example of a regulator that is moving forward with its responsible investment agenda, the Charity Commission has currently put its plans in this area on hold as it awaits a court judgment.

As covered in this supplement last year, the Commission had launched a consultation on updating its guidance on responsible investment, which led to it identifying a number of barriers that charities faced when deciding whether to adopt this kind of approach. It had published draft new guidance but the outcome of the consultation on this has been delayed.

Some within the sector have argued for more legal clarity around the rights and duties of charities when it comes to investing responsibly. The previous legal case, widely known as the Bishop of Oxford case, took place in 1992 and involved the Bishop of Oxford challenging the Church Commissioners for England over its investment policy. The bishop argued that the Church Commissioners should apply an ethical filter to its investments in order to ensure they aligned with Christian beliefs and values.

The outcome of this case recognised that there were times when a charity may wish to pursue an ethical approach to its investments, but that this is a secondary consideration to generating income. Ethical investments would be adopted if an investment directly conflicts with a charity's aim or would alienate supporters of beneficiaries. If a charity felt a moral imperative to apply an ethical filter to its investments, it would need to demonstrate that there is no risk of significant financial detriment, the ruling said.

This has become to be seen as outdated as the responsible investment market has evolved and there is increasing evidence that responsible investment does not necessarily lead to lower returns. Charities are also facing increased pressure (and feeling an increased desire) to invest responsibly.

As a result, on 14 April 2021, two charities were granted permission to bring a case relating to responsible investments to the High Court in an attempt to clarify the legal position.

"As the court's decision may affect our draft guidance, we will consider any further steps once the court has given its judgment," the Commission said.

At the time of writing, the judgment of this new case is still awaited, so it is unclear when the Commission will be able to update its guidance.

IMPROVING STANDARDS

While charities will read the judgment with great interest, when it comes to implementing a responsible investment policy, most charities have to rely on their investment managers. They simply do not have the resource or expertise to manage their own investment portfolios.

Although most investment management firms actively market their responsible investment

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Interview with CONAN MCKENZIE

Portfolio Manager –
BlackRock Multi-Asset Charity funds

Responsible investing is a balance between financial and social return

A core principle of all charities is to have a meaningful and positive real-world impact. That is why they exist. Conan McKenzie, portfolio manager of a range of multi-asset charity funds, believes that this also has to be true of how they invest.

"We want to invest our clients' money in a way that's consistent with their values and how they would be investing it were they to manage it directly themselves," he says. "We have a fiduciary responsibility to our clients to grow their assets."

"Negative screening won't change the world"

Negative screening plays a role in order to make sure investments don't contradict charity client's values, and to help build trust among their stakeholders, says McKenzie.

"Some companies and sectors do have negative social impacts and obviously we don't want to contribute to that, so we apply negative screening to our portfolios. But negative screening on its own won't change the world.

"What is much more exciting is thinking about how we can have an impact on the real world through the investments that we make."

When it comes to measuring real-world impact, benchmark comparisons and quantitative data around carbon emissions, for example, provide some indication of a portfolio's performance on environmental, social and governance (ESG) metrics.

However, McKenzie believes that by investing directly in primary markets you can witness much more tangible effects.

He adds: "Giving money directly to the company or infrastructure vehicle increases the amount of capital they have in order to have a real effect in the world. The key is to be concerned not only with financial market data, but also with real-world data; looking at what has positively changed as a result of investment decisions."

POSITIVE INCLUSION

One area of investment that exemplifies this strategy is in renewable energy, says McKenzie. In 2013, BlackRock invested through its charity funds in the initial public offerings of two solar energy infrastructure vehicles, and has since expanded this to other investments in wind and hydro power generation.

"It's a great example of how your investments can help drive change. We can point to solar and wind generation assets that would not

What we do

At BlackRock we aim to understand the challenges that charity Trustees and their investment committees face, particularly in uncertain markets. On the one hand they need to generate enough real capital growth and income from their investment portfolios to fund their vital work and, at the same time, they must manage the 'risk vs reward' balance. In addition, many charities face an imperative to deliver against their sustainable investment goals. That's why we've built a family of charity-focused strategies to give investors the breadth of choice they require to meet their objectives, as well as a dedicated relationship management team.

BlackRock.

FAST FACTS

- Over 30 years of experience managing charity assets
- Manage approximately £6.3bn for over 3,000 UK charities
- Seven charity specific investments funds
- Individual portfolio management for larger charities

Source: BlackRock, December 2021

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have been built if we had not directly invested in these vehicles. Now these renewable energy assets exist and are plugged into the UK and European power grids."

From a financial point of view, the investment case is also pretty compelling. "When we were looking at this nine years ago, there was a lot of discussion around having to sacrifice financial returns in order to have a positive impact, as opposed to say the margins involved in investing in existing utilities companies using coal or gas power generation. But in fact, the opposite is true. Wind and solar are proving extremely profitable, whilst giving inflation-linked income for our charity funds. So, not only is it the right thing to do, it is also very aligned with the financial goals of our charity clients."

These types of investments are also extremely stable, says McKenzie. "Our goal as an investor is to try to diversify to reduce risk. However, finding true diversification can be hard. What's great about investments in renewable energy, is there is no correlation between how much the wind blows or the sun shines in any one year with how markets perform. So you are getting genuine, long-term diversification, which helps contribute to a smoother journey for charities in terms of growth and income."

BUILDING TRUST

Although investing in renewables has now become much more mainstream, back in 2013 it was newer for investors, notes McKenzie.

"At the beginning, it did make some people nervous. But we have been doing this for nearly a decade now and have shown that it can work. We have been able to build up trust with our charity clients and create long-term relationships."

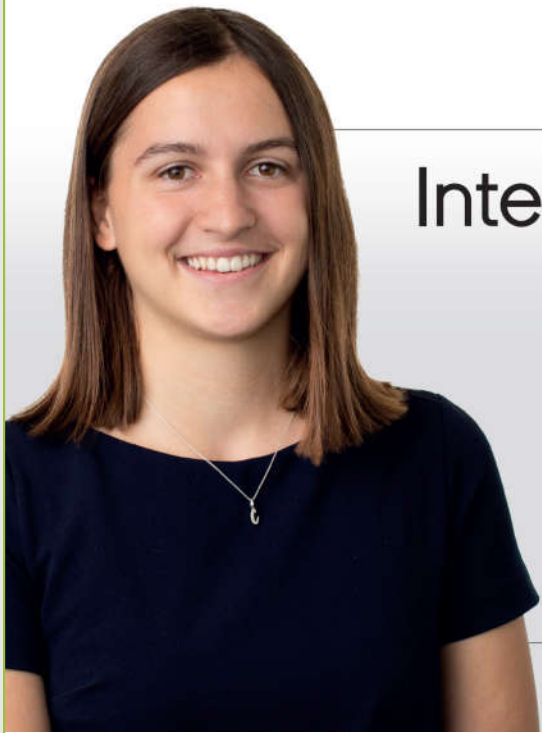
INVESTOR PURPOSE

Over the years, other investment companies have followed suit and McKenzie says that is good thing. "A pound invested by one of our peers can have as much of a positive impact as a pound invested by us.

> "Wind and solar are proving extremely profitable"

"Ultimately, the purpose of the investment industry is to take capital from people who own it and want to grow it over the long term, and to provide it to people who can use it in a way that is productive for society and for the world as a whole.

"That's what we are here to do. If we invest the money from our charitable clients, and direct it towards companies which can use it productively in the real economy, to generate not only social return, but also a financial return for our clients, then we've done our job."



Interview with CARLOTA ESGUEVILLAS

Responsible Investment Analyst – EdenTree Investment Management

To have real impact, funds need to strive to be aligned with the goals of the Paris Agreement

According to responsible investment analyst at EdenTree Investment Management, Carlota Esguevillas, when talking about climate change it is key to define what it means, and understand what your impact is. "Everyone is well aware of the urgency around climate change and the environment but it is essential to take a step back, think about what the terminology really means, and what you want to achieve."

> "The net-zero approach is a much more credible pathway"

One of the starting points is to think about the difference between carbon neutral and net-zero pathways, she says. "If you are thinking about carbon neutral, you are usually talking about a reliance on offsetting to achieve your goals. On the other hand, if you are looking at net zero, then you are actually talking about taking real action to reduce your footprint. The net-zero approach is a much more credible pathway."

To help charities use their investments to achieve their climate change targets, EdenTree has a number of core principles that guide its responsible and sustainable investment policies. For the last six years it has been measuring the carbon footprint of all its funds, as well as being a signatory of the Montreal pledge. But fundamental to its philosophy is ensuring that investment funds are aligned with the Paris Agreement. "Some investors talk about the green credentials of their funds, but when you look under the bonnet, they are not at all robust. We map out all the data of our funds to make sure they are aligned with a 1.5-2 degree warming pathway. All our charity funds are within that range. When compared with the benchmark MSCI or FTSE World Index, which have warming potentials in the 3-4 degrees range, it brings to life the impact charity investors can have by taking a climate active approach."

INVESTMENT STEWARDSHIP

To maintain that level of impact takes a high degree of engagement with investee companies. "There is a lot of technical data gathering, looking at carbon budgets and different sustainable development scenarios, so that we can determine what the footprint of each fund is," says Esguevillas. "One of our key engagement priorities every year is to encourage the highest emitters in our funds to set science-based targets, which allows us to track their progress and ensure they are on the pathway to decarbonise in line with the Paris Agreement."

Ultimately, keeping companies focused on these priorities comes down to good stewardship. Esguevillas notes: "We have voting rights, but that is just one part of it. We try to meet with every company in our funds to discuss a range of different environmental, social and governance (ESG) topics and look at ways to improve corporate practices. Obviously, every company in our funds is a company that we feel is suitable to be included, so we are starting from a relatively high base. But we recognise that expectations around climate are constantly changing and that the standards are moving. We want to engage with companies to encourage them to move faster and to be more ambitious."

Stewardship at this level involves a delicate touch, suggests Esguevillas. "We aim to develop constructive relationships with companies in our funds. We try to understand their challenges, we congratulate them when they do something positive, but we also challenge them to go further and go faster."

MAKING AN IMPACT

For many, COP26 failed to live up to its billing and many fear that the pace of change will not be fast enough. However, Esguevillas says there are some positives to come out of the latest climate summit.

"Clearly COP26 wasn't perfect but I think the determination and ambition of businesses to lead the conversation and tout their green credentials was a real step-change. They were the ones putting pressure on governments and you can see that momentum has continued, with businesses really driving the agenda."

The key thing, says Esguevillas, is for charity investors to know that, regardless of their size, they too can have an impact with their investments. "There's perhaps a sense that climate change may only be for businesses and governments or large charities and large foundations, but I think that's definitely not the case. Even the smallest charity has a role to play in climate change. With their investments specifically, no matter how much they have to invest, it can make a difference. It doesn't impact your returns at all, so it really is a win-win in every sense."

> "Even the smallest charity has a role to play in climate change"

This can extend beyond a charity's investment strategy to include the overall integration of sustainable practices within their own operations, suggests Esguevillas. "I completely understand the focus on the needs of beneficiaries and cost is obviously very important, but a lot of initiatives are actually cost saving. Our main role is on the investment side, but we can also help charities navigate the journey to reduce their own carbon footprint and communicate that to donors and beneficiaries."

offerings and promote their level of expertise, there are still concerns among charity investors (and, indeed, other investors) of firms not having a rigorous enough approach or overstating their credentials.

The investment industry itself also seems to want to increase standards. A survey carried out by the CFA Institute found that 78% of the investment professionals that responded said "there is a need for improved standards around ESG products to mitigate 'greenwashing'".

Meanwhile, the PRI has identified what it calls "the prevalent ESG skills gap within the investment sector". It says: "While ESG has become a dominant theme in the industry in recent years, firms increasingly face a challenge in ensuring their staff are familiar with key ESG issues at every stage of the investment process."

In order to address this concern, the organisation's education arm, the Academy, has launched three courses designed for staff in all levels and roles, developed in conjunction with PRI subject-matter experts and thought leaders across the industry.

"Public awareness of ESG issues has increased markedly in recent years and ESG-aligned funds have begun to attract higher inflows," a statement from the PRI says. "However, as the theme has become more mainstream, it has increasingly become necessary for staff beyond those with direct responsibility for managing money to have a working understanding of ESG issues, in order to represent a firm's activity accurately to external stakeholders and ensure that ESG considerations are truly integrated throughout the organisation."

> " Public awareness of ESG issues has increased markedly "

Charities can also help to ensure high standards by asking the right questions to hold their investment managers to account. In order to help with this, a coalition of charities launched eight minimum standards during COP26 that investment managers should adhere to around climate-related issues (for full details on this project, see page 43).

ENGAGEMENT AND DIVESTMENT

These higher standards from investment managers are arguably more important as shareholder engagement is seemingly becoming the industry norm. If the investment profession had decided to pursue a path of total divestment from controversial sectors, the expertise needed would be considerably lower.

Of course, some charities will undoubtedly have some sectors or areas that they want to exclude, but the message from investment managers is that engagement is an effective tool to create change. They say that by being an active shareholder, engaging with management and voting at AGMs, investors are able to make improvements in companies' policies and behaviour.

But is this really the case?

There certainly is some evidence that it is. A 2021 academic paper from Jonathan B. Berk of Stanford Graduate School of Business and Jules H. van Binsbergen of University of Pennsylvania found that there were benefits to engagement (see https://stanford.io/37g3H0P).

"Given the current levels of socially conscious capital, a more effective strategy to put that capital to use is to follow a policy of engagement," the paper, entitled The Impact of Impact Investing, concluded. "By purchasing the stock in targeted companies rather than selling the stock, socially conscious investors could potentially have greater impact by exercising their rights of control through the proxy process or by gaining a majority stake and replacing upper management."

Part of the reason for this conclusion is the failings of a policy of divestment. "The reason divestiture has so little impact is that stocks are highly substitutable, and socially costly stocks make up less than half of the economy," the paper states. "It therefore does not take much of a price change to induce an investor who does not care about the social costs to hold more of a stock than they otherwise would. To put this in the language of modern finance, when socially responsible investors divest, they must induce other investors to move away from their fully diversified portfolio."

For most investors there will come a time when, if engagement has not had the desired outcome, divestment is the final outcome. This should follow an escalation policy but can be the threat that helps make engagement effective.

Wherever you sit on the engagement-versus-divestment debate, it is clear that there is power in numbers. The more investors that start to put pressure on the companies they invest in, the more effective they will be. Charities should feel empowered to be part of that investor pressure. ●

Further divestment from oil and gas

In this supplement last year, we reported on the Central Finance Board of the Methodist Church (CFB) selling investments of just over £17m in two major oil firms, namely just over £15m in BP and just over £2m in Total.

At the time, this left CFB with investments in four oil and gas firms, but since then it has divested all of its oil and gas holdings.

The sale of these investments came after the Methodist Church's Joint Advisory Committee on the Ethics of Investment (JACEI) advised in April 2021 that no company in the oil and gas sector is currently aligned with the climate change targets set out by the 2015 Paris Accord.

"The committee has determined that the slow pace of corporate change means that the oil and gas sector is failing to meet the targets set by the Paris Accord," Revd Dr Stephen Wigley, chair of JACEI, said at the time. "Shell, along with its peers, is currently failing to play a substantial enough role in addressing the climate emergency."

Charities draw the line on asset management greenwashing

Asset managers need to be held to account on their climate claims and Colin Baines *urges charities to do so via eight minimum standards*

"NO MATTER A CHARITY'S OBJECTIVE, ALL HAVE A RESPONSIBILITY TO BE CONSISTENT WITH KEEPING GLOBAL WARMING BELOW 1.5°C"

Colin Baines *is investment engagement manager at Friends Provident Foundation*

IN THE run-up to and during the COP26 climate change conference in Glasgow in November, we anticipated ever more climate commitments and claims of leadership from asset managers. But scratch the surface and there is a huge variance in the policy and practice of different managers, with the use of product labels such as green, sustainable, and ESG often fanciful compared to practice.

To assist other asset owners, journalists, civil society, and politicians to judge what is good practice and what is greenwash during COP26, and to send a strong market signal for higher standards, 27 asset owners with investments of £7bn came together to publicly make clear their minimum climate expectations of the asset management industry.

The COP26 Declaration of Asset Owner Climate Expectations, launched at a fringe event during the talks, was organised by Friends Provident Foundation, its grant recipient Students Organising for Sustainability (SOS), the Charities Responsible Investment Network (CRIN), and Responsible Investment Network Universities (RINU).

Among its founding signatories are the charities WWF UK, the Health Foundation, Joseph Rowntree Charitable Trust, Joseph Rowntree Foundation, Barrow Cadbury Trust, EIRIS Foundation, Lankelly Chase, Access Foundation, Joffe Charitable Trust, Blagrave Trust, and John Ellerman Foundation.

The declaration remains open to new signatories, who commit to use its eight minimum standards as considerations in asset manager selection, monitoring, and reviews. By coming together as mission-led asset owners, with scores of asset managers between us, we hope to help establish these standards as market norms and dramatically improve the overall effectiveness of the asset management sector in addressing the climate crisis.

> "We hope to establish these standards as market norms"

They are minimum standards, not best practice, but draw a line on asset management greenwashing by establishing a baseline to judge them against.

GREENWASHING

We have found it is commonplace for asset managers that claim to support the Paris climate agreement or net-zero to vote against aligned shareholder resolutions.

Recent research from ShareAction examined how 65 of the world's largest asset managers voted on 146 social and environmental resolutions in 2021. Some 44 of the 65 assessed managers failed to vote in favour of all the resolutions recommended for support by large proxy adviser ISS (who backed 75%).

On top of this, the six largest, BlackRock, Vanguard, Fidelity Investments, State Street Global Advisors, Capital Group, and J.P. Morgan Asset Management all supported less than 40% of resolutions that they voted on. UK laggards included Baillie Gifford with just 33% support, Invesco 37%, Janus Henderson Investors 44%, and Liontrust Asset Management 50%.

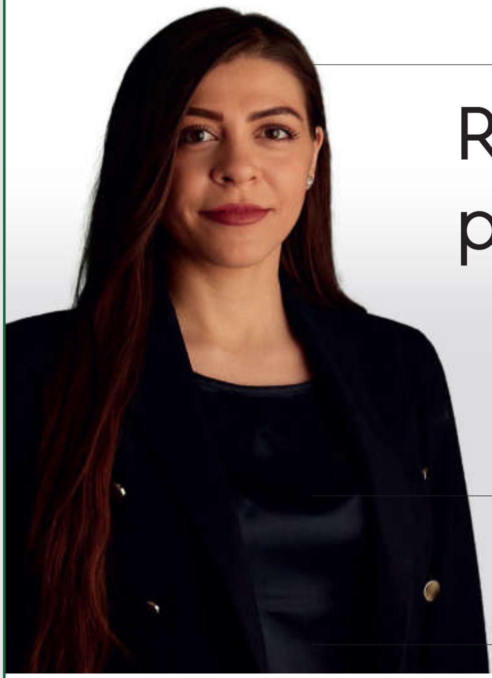
As a result, just 21% of the 146 ESG resolutions received over 50% support.

To underline the huge variance in asset manager practice, UK leaders included Impax Asset Management Group, which voted for 99% of the resolutions, Aviva Investors with 91% support, and Man Group with 90%.

To also highlight how few asset managers have meaningful engagement escalation policies, which we would expect to include filing resolutions, only six of the world's largest 65 asset managers filed or co-filed any of the 146 ESG resolutions assessed.

As asset owners, we have few independent indicators of whether an asset manager is taking climate change seriously. Many managers cite memberships of collective sector initiatives, such as the Climate Action 100+ (CA100+), but again we see a huge variance in the behaviour of its members. For example, members Amundi and Aviva voted for over 90% of the ESG resolutions while another supported just 40%.

▶ *p46*



Responsible investment post-pandemic

LORENA CEBUC
Associate, Responsible Investment – Ruffer

Covid-19 has shone a spotlight on the social element of ESG investing

How has the pandemic increased awareness of the 'social' in ESG?

The environmental, social and governance (ESG) space is constantly evolving. What began with a focus on governance, then moved to be dominated by environmental issues, is now turning its gaze to social considerations.

The Covid-19 pandemic placed global supply chains in the headlights. The fragility of sprawling global networks of production has been brought into focus, and in doing so, this has brought awareness to the vast number of stakeholders involved in the process. A study by KPMG (2021) of 500 CEOs across 11 markets found that 96% of respondents agreed that the pandemic had shifted their focus to the social component of ESG.

Stakeholder management takes on newfound importance in moments of crisis. Over the course of the pandemic, companies have been scrutinised for their management of supply chains, treatment of staff and for ensuring the safety of their customers. As a result, the dialogue around the social in ESG has broadened. Companies are increasingly bound by the "new social contract", wherein they are under pressure to ensure equitability and security for stakeholders.

> "Engaging with companies on social issues is critical"

How are social issues being considered by investors?

Given a renewed focus on social issues, there is now an increased expectation for investors to evaluate a company's record on diversity, equity and inclusion, among other social factors. These should be considered in investment research.

These are not necessarily new themes, but the unequal distribution of the pandemic's effects has placed them at the forefront of investors' minds. For example, the evidence that the pandemic disproportionately negatively affected minorities and people of colour has increased awareness of embedded biases and inequality. Additionally, the risks taken by "essential workers" has drawn attention to the critical role that some of the lowest-paid workers play in the economy.

In the US and the UK, structures are in place to quantify workplace diversity and inclusion. For instance, the Equal Opportunities Act in the US requires the disclosure of demographic workforce data for all private companies with greater than 100 employees. In the UK, all employers with more than 250 employees are required to disclose their gender pay gap. Yet data is not reported on a systematic manner across the globe, and this creates difficulties for investors wishing to compare companies.

What we do

At Ruffer, our goal is to deliver consistent positive returns – whatever happens in financial markets.

By putting safety first, we have protected our clients' capital when needed most – and make them good money in the process.

Through boom and bust, for over 27 years, this is our sole focus.

RUFFER

FAST FACTS

- Over £24bn in assets under management
- Dedicated Responsible Investment Team
- Over 25% of charity assets managed with ethical restrictions
- ESG fully integrated into investment process
- For more information please contact investment manager Ajay Johal (ajohal@ruffer.co.uk) +44 (0)20 7963 8040

Is pressure mounting to enhance ESG credentials?

Pressure is mounting on corporate boards and governments to "walk the talk" on ESG commitments. There has been a spree of company commitments to meet net-zero targets by 2050, and efforts by investors to scrutinise these transition plans are increasing. At Ruffer, we encourage a two-way dialogue and we have seen a number of companies reaching out for feedback on their ESG strategy and disclosures.

Shareholder activism is likely to continue to grow through 2022, in the wake of the momentum generated by COP26 around environmental targets. This will also be facilitated by the November 2021 decision of the US Securities and Exchange Commission to rescind Trump-era restrictions on shareholder resolutions. As such, in the upcoming proxy season we are likely to see emboldened shareholders challenging corporate boards and government leaders to progress their ESG credentials and targets.

With regard to real-world reductions in greenhouse gases, investor engagement should focus on ensuring that achievable near-term signposts are stated on the path to decarbonisation. Often, commitments lack interim emissions reduction targets or fail to account for emissions across the value chain. This damages the credibility of transition plans and makes it harder to hold management to account.

> “Assessing risks to natural capital and biodiversity will continue to gain traction”

How is regulation tackling greenwashing?

It can be challenging to identify genuine progress due to potential greenwashing. In order to allocate capital efficiently, investors must have access to reliable data. At present, ESG-related data is reported under a mixture of frameworks and is unstandardised, making it challenging for investors to compare data on ESG progress.

Regulatory authorities are waking up to the challenge and we expect that the quality and quantity of ESG data will continue to grow in 2022. During COP26, the International Financial Reporting Standards Foundation, created the International Sustainability Standards Board (ISSB). The ISSB is tasked with generating a baseline for disclosure standards, applicable across countries and industries. This will reduce informational obstacles to holding management accountable.

Another key development in 2022 will be mandatory reporting under the Task Force on Climate-Related Financial Disclosures (TCFD) for UK firms, in place from April 2022. The TCFD requires the disclosure of the organisation's governance around climate-related risks and opportunities. Similarly, we expect that assessing risks to natural capital and biodiversity will continue to gain traction, particularly as the Taskforce on Nature-related Financial Disclosures is developed.

The greenwashing also extends to how they are managing their own transition to net-zero.

The Net Zero Asset Managers Initiative (NZAMI) is another membership organisation cited by managers as evidence of taking the climate crisis seriously. But so far just 43 of its 220 members have published the percentage of assets under management (AUM) that are covered by their net-zero commitment. The average is just 35%. One member has announced that its net-zero commitment covers just 1% of AUM.

It would assist us and their credibility if CA100+ and NZAMI were to introduce robust minimum standards for signatories. As it stands, these important initiatives are providing cover for greenwashing.

In the absence of helpful market indicators and regulation to prevent greenwashing, it is for like-minded asset owners to help each other and help establish the market norms and social license to operate. It is our demand that is driving the boom in ESG and green investing and it is our money being invested.

That is why we worked with our partners to develop and launch the COP26 Declaration of Asset Owner Climate Expectations and why we are engaging our asset managers to assess them against the eight minimum standards and encourage full compliance.

No matter a charity's objective, all have a responsibility to transition their purpose and operations to be consistent with keeping global warming below 1.5°C. How an endowment is invested is of key importance but it is not easy to judge managers' climate claims.

The COP26 declaration provides a means to do this, and co-signatories provide the opportunity to collectively engage shared asset managers to adhere. We would encourage others to sign up to the declaration ,which is already starting to yield results: https://www.cop26declaration.uk/ ●

The eight climate expectations of asset management

Strategy

1. An investment strategy covering all assets under management to achieve net-zero emissions by at least 2050, with at least 45% emissions reduction by 2030 at the latest, as recommended by the Intergovernmental Panel on Climate Change (IPCC). The scenario used should be aligned to the 1.5°C ambition in the Paris Agreement and not overly reliant on negative emissions technologies. Responsibility for the climate investment strategy should be at board level, and remuneration policies should be linked to achieving climate objectives.
2. Operational alignment with achieving net-zero by 2050 and 45% emissions reductions by 2030, covering property, travel, and corporate lobbying.

Asset allocation

3. Exclusion of coal and tar sands, which are incompatible with a 1.5°C pathway, from active strategies. Other sectors should also be considered for exclusion, for example unsustainable timber. A list of excluded companies should be made publicly available.
4. An active commitment to invest in solutions to climate change. These investments should be focused on driving solutions forward to achieve a just transition to a decarbonised economy.

Active ownership

5. A presumption to vote in favour of shareholder resolutions on climate change, taking a "comply or explain" approach with public disclosure of rationale. Asset managers who support the objectives of the Paris Agreement should implement this by voting in favour of resolutions aligned with those objectives. Asset managers should also consider voting against management-proposed resolutions, such as director re-elections, where the company's strategy is not aligned with the goals of the Paris Agreement.
6. Active shareholder engagement on 1.5°C aligned transition plans across sectors and asset classes. Investee companies should be engaged with to set short- and medium-term science-based targets, eg 45% emissions reductions by 2030, IPCC and a net-zero target for no later than 2050 that is not overly reliant on negative emissions technologies. Transition plans should include corporate lobbying, capital expenditure, and remuneration strategies. Transition plans should also incorporate social risks and opportunities to ensure a just transition.
7. Engagement escalation policies should be developed and disclosed, which include details on how and when engagements will be escalated. This should include escalation to voting against management-proposed resolutions such as director re-elections, co-filing shareholder resolutions, and ultimately divestment or refusal to purchase new bonds in active strategies.

Transparency

8. Regular disclosure of holdings, voting record and engagement activity. Voting records should be published as soon as possible after the AGM and include rationales on votes against management as well as votes on shareholder resolutions. Disclosure on engagement activity should outline engagement objectives, methods of engagement and escalation, as well as assessments of progress and outcomes against defined objectives.

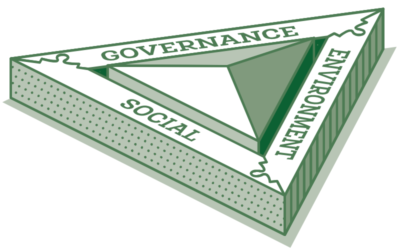
Steps for charities on their responsible investment journey

The majority of charities need to step up and join the pioneers to ensure their investments, and our finance system, better reflect their purpose and values, says Lisa Stonestreet

"ONE OF THE BENEFITS OF HEIGHTENED INTEREST AND DEMAND FOR RESPONSIBLE INVESTMENT IS THE WEALTH OF RESOURCES NOW AVAILABLE"

Lisa Stonestreet *is head of communications and charity impact at EIRIS Foundation*

ETHICAL INVESTMENT has a long and established history in the UK. The first ethical funds in the UK, the Stewardship range, were launched in 1983 and EIRIS was established by the EIRIS Foundation as the UK's first independent research service for ethical investors in the same year. These developments were pioneered by charities and faith groups. Some 40 or so years later and there are still charities and foundations challenging the finance sector and pushing for meaningful, impactful inclusion of environmental and social issues in the investment process. What has changed dramatically in this time is the widespread acceptance of the importance and materiality of environmental, social and governance (ESG) factors on investments and investment management. ESG is now "mainstream" but what does that mean for charities and foundations in the context of both their own investments and just as importantly, in a much wider context for the environmental and social issues that the financial sector, and the flow of money it facilitates, impacts hugely? It means there has never been a better time, or more urgent need, for charities to ensure it is not just the pioneering few which are working to align the financial system with climate security and sustainable development. Looking beyond ESG as merely risk-mitigation, charities have an opportunity to ensure that the finance system, a vital lever for achieving sustainability, is part of the solution rather than the problem.



> There are still some charities challenging the finance sector

Many charities actively embrace the leverage they exert on the financial system through their own investment assets and by advocating for change and best practice. But at the EIRIS Foundation, through our work in helping charities to adopt and shape responsible investment in all its forms, we still don't see a critical mass of charities using the power of their money and their influence to its full extent. There still seems to be a misperception that a charity can either focus on its finances and its investment returns or a financial system that really serves both people and planet. Charities need to stop thinking in terms of this false dichotomy.

At the EIRIS Foundation we don't believe there are any legitimate arguments against charities and foundations not taking into account:

- Current best practice and innovations in the responsible investment landscape.
- Societal expectations and need with regards to, among other issues, the climate emergency and the ways in which investment can be part of a solution.
- The need, and desire, from multiple stakeholders for charities to adopt forward-thinking approaches that are, at the very least, aligned to other regulatory developments around responsible investment (such as current pensions guidance on climate).
- The degree to which thinking around responsible investment and ESG has moved on in recent years dispelling the myth that there is an either/or decision between financial returns and responsible investment.

Charities looking to make progress in this area may feel daunted by the broad scope of the discussion and the many potential details to consider, but starting with these three general aspects may help.

REVIEW YOUR POLICY

Looking at your policy again with a fresh perspective may be helpful, and long overdue. Last year the EIRIS Foundation went through a public request for proposal (RfP) process in search of investment managers for our relatively small investment capital pot of £1m. Before starting this process, we updated our responsible investment policy to use as a basis for our request for proposals.

We started from the following principles which may be helpful for many charities to consider their own approach to:

a. A positive focus: As we are a charity with a broad mission (we exist partly to work with other charities to advance the contribution p52

ESG: opportunities ahead

CAROLINE RAMSCAR
Head of Sustainability Solutions

RICHARD LUBBOCK
Client Director, Charities
– Legal & General Investment Management

This year provides opportunities to have real-world impact

What opportunities lie ahead this year?

Caroline Ramscar: 2021 really was the year of environmental, social and governance (ESG), spearheaded by COP26, headlines on the climate crisis, and discussions around how we can all help play our part. We expect this spotlight to intensify in 2022.

At LGIM we are already seeing our charity clients adopting more sustainable climate benchmarks, looking at their carbon footprints, and considering where they can make changes that will benefit society. Charities have been at the forefront of thinking around ethical and climate considerations for a number of years.

> “Charities have been at the forefront of thinking around ethical and climate considerations”

Richard Lubbock: With increased expectations around how charities deploy their investments – along with an increased understanding that there no longer needs to be a choice between doing the right thing and performance – we believe more of our charity clients may look to making shifts into mainstream ESG funds.

CR: Following the themes raised at COP26, we also expect that discussions will split off into other areas, such as biodiversity loss and deforestation. Charities are already starting to ask about what these issues could mean for their portfolios, and our engagements with companies in these areas.

RL: Charities themselves have a clear societal purpose, so we work closely with our clients not just on the “E” considerations covering the environment, but just as importantly on social and governance issues. LGIM has been focusing on these issues for a number of years; healthcare is a core long-term theme for our stewardship team, and we are seeing increased interest in this area, particularly where charities have started to think about their investments following the Covid-19 pandemic.

CR: Another important area of focus is diversity. We know there has been much work and progress around gender diversity in recent years, but there is much more to be done to improve wider diversity and representation. We have been looking at diversity for a number of years, something that is reflected in our voting and engagement policies, and we are now starting to vote from an ethnic diversity perspective and will vote against boards where ethnic diversity representation is lacking.

We fully encourage charities to question their asset managers more rigorously around these new areas of focus.

What we do

We are here to help organisations make the most efficient use of their investments. At a time when the call to the third sector is greater than ever, we partner with our clients to help them achieve their investment goals, whether that is long-term growth above inflation, income, capital preservation or an element of all three. We pride ourselves on offering straightforward, cost-effective solutions to our clients, supported by award-winning client service. LGIM is building on its credentials as a responsible investor to lead the asset management industry in addressing the dramatic challenges posed to by a rapidly changing world. We believe this activity is crucial to mitigate investment risks, capture opportunities and strengthen long-term returns for our clients.

LGIM

FAST FACTS*

- Top 10 charity manager
- £4.5bn of charity assets entrusted with us
- True active owners of capital
- Over 66,000 votes cast in 2020 alone

*Figures as at 31 December 2020

How can charities achieve sustainability objectives?

CR: The best way for any asset manager to help clients meet their objectives, is to provide robust investment solutions – the investment case has to stack up. We also work in partnership with clients to help meet their obligations or objectives. For example, a client may have their own decarbonisation goals, or specific mandate requirements. We aim to provide the capability and mainstream solutions that are aligned with the charity's risk-return profile and provide the asset-class exposures that they require.

LGIM's climate solutions, which are available across our index range of products, are a good example of this capability. Embedded within the range are decarbonisation targets for alignment with the objectives of the Paris Agreement. For those clients that want to reflect broader ESG considerations, we believe our ESG-tilted index strategies may be an option, allowing clients to achieve market-cap exposure, while aiming to meet sustainability objectives such as reduced carbon emissions intensity versus the benchmark or an improved diversity profile.

We have also partnered with fintech company Tumelo to explore ways of tackling specific themes that beneficiaries care about. For example, in 2021 pay and climate were highlighted as key issues through our insights from the Tumelo platform. We can help people to better understand how their investments align with these principles.

> “Healthcare is a core long-term theme for our stewardship team”

What new trends are you seeing?

CR: We know we don't have time to wait in tackling climate change, so broader regulations, and particularly the government's net-zero strategy, have prioritised climate and the “E” considerations. But we know that we must not forget about the “S” and the “G”. Areas such as executive pay, diversity at board and wider company level, and healthcare are increasingly under the spotlight.

As the year progresses, there will also be a greater focus on greenwashing. There will be much tighter rules and regulations to make it clearer to investors what is held within their funds.

There is also going to be a lot more focus on whether funds are doing what they say they are and evidencing back to stakeholders their climate and sustainability credentials. This can provide a real opportunity in 2022 to make a difference.

The fight against greenwashing

ALEXANDER TRUE
Business Partner – Sarasin & Partners

Charities need to make sure their asset managers are committed to sorting the green from the greenwashed

Has new regulation stopped greenwashing?

Despite action by regulators, greenwashing continues. Investors' desire to make a positive difference has driven huge inflows into strategies that make sustainability claims. However, mounting evidence that a number of "sustainable" strategies were not as green as they seemed has galvanised regulators to act.

The European Union's Sustainable Finance Disclosure Regulation (SFDR) was introduced in 2019 to impose tougher disclosure requirements, with the aim of giving investors greater insight into the sustainability-related impact of their investments.

Asset managers complying with SFDR are repositioning their products as "promoting environmental or social characteristics" in order to meet the requirements of SFDR Articles 8 and 9 and retain their sustainability badges. However, given that SFDR permits a high degree of flexibility in defining what "promoting" sustainability means, there is still potential for misunderstanding.

Rather than trusting to high-level descriptions of investment approaches, clients should be prepared to dig deeper. With this in mind, we have put together a shortlist of seven questions to help investors sort the green from the greenwashed.

> "Despite action by regulators, greenwashing continues"

What can investors do?

First, check if your asset manager is a signatory of the UN Principles for Responsible Investment (UNPRI). Being a UNPRI signatory involves an extensive application and assessment process and ongoing commitment to UNPRI reporting. Signatory status is not a given, and asset managers that fail to uphold UNPRI standards may lose signatory status after a two-year watch period. The minimum requirements for UNPRI signatory status are: having a responsible investment policy that sets out an overall environmental, social and governance (ESG) approach or guidelines; providing evidence that the policy covers more than 50% of assets under management; and evidence of senior management oversight and staff implementation of responsible investment.

Second, check if your asset manager has published a UK Stewardship Code Statement. Responsible companies create durable economic value not only for investors but also for society. If your asset manager is a signatory to the Code, then this insight is more likely to be central to their investment approach. It sets high stewardship standards for asset managers. It defines stewardship as the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries, leading to sustainable benefits for the economy, the environment and society. Signatories publish an annual statement showing the extent to which they have implemented these principles.

What we do

Sarasin & Partners LLP is a London-based asset manager that manages £21bn on behalf of charities, institutions, intermediaries, pension funds and private clients, from the UK and around the world. Consistent with a longer-term approach is a commitment to stewardship principles.

Our goal is to grow and protect our clients' capital in a way that is aligned with a sustainable society. We achieve this through a global thematic approach to investment that embeds rigorous ESG analysis; a proactive ownership discipline which promotes responsible behaviour; and a commitment to engage in the wider market place to press for changes that support responsible growth.

SARASIN & PARTNERS

FAST FACTS

- Sarasin manages £9.1bn for over 475 charity and not-for-profit clients
- Charities represent nearly 45% of total business
- The Climate Active Endowments Strategy has been adopted by c£1bn of charity assets, £500m reside in the Sarasin Climate Active Endowment CAIF

*All figures as at 31 December 2021

What can asset managers do to catalyse positive change?

Having an overall approach or guidelines for ESG is one thing, but integrating ESG into an investment process in a way that goes beyond simply excluding controversial companies requires much more detailed work. Sarasin & Partners has fully integrated ESG in its investment processes: from idea generation in long-term thematic trends such as climate change and automation, to stock selection that incorporates bottom-up ESG and climate impact analysis and in portfolio construction, where we decide our engagement plans. We outline how ESG is integrated into our investment process in our 2020 UK Stewardship Code Report (see link below).

Active engagement is also essential. Investors have important rights, but they also have responsibilities to promote sustainable business practices and hold management responsible through thoughtful voting and engagement company management. This has a pivotal role to play in improving sustainable business practices and asset managers should be prepared to dedicate resources to ongoing engagements that may take years to play out.

Policy outreach is another important way to drive change. Where there is scope for a ripple effect, investors can, and should, make public calls for change and build coalitions with like-minded stakeholders through initiatives such as the Net Zero Asset Managers' Commitment.

> “Asset managers should regularly publish their voting record”

What else can be done?

Vote actively to encourage improvement in corporate behaviour. Shareholders' votes are a powerful tool that can be used to change corporate behaviour for the better. We believe that asset managers should vote actively against harmful corporate practices. For example, we vote against company directors where we see inadequate action to align strategies and operations with a 1.5°C cap on global temperature rises. We are also one of only two asset managers that vote against auditors who fail to call out unsustainable company accounts.

Furthermore, asset managers should regularly publish their voting record. This promotes progress and corporate accountability by publicly acknowledging best practice and placing the spotlight on poor performers. It also ensures that clients can see whether their asset manager is acting in a way that aligns with their corporate governance and investment policies.

FOR MORE INFORMATION SEE:

- sarasinandpartners.com/wp-content/uploads/2021/03/Sarasin-UK-Stewardship-Code-2020.pdf
- sarasinandpartners.com/stewardship/how-we-vote-for-you/
- sarasinandpartners.com/think/securing-tomorrow-with-the-net-zero-asset-managers-commitment/

of ethical or responsible investment to their objectives) we prefer to see our own investments in companies whose products, services and practices align with one or more of the heads of charity under which charities may operate in the UK. We see the Sustainable Development Goals (SDGs) as a useful framework for this.

b. Negative screening: We wanted to avoid any investment (across all direct or indirect investments) in companies whose activities directly undermine any of the objectives of charities we might support and would prefer to avoid any investments that have less direct negative impacts on their missions. We also seek to avoid investments in companies or funds that are rated badly in our research work or whose activities are part of the cause of any particular problem we are addressing in any part of our work.

c. Public benefit: We believe that the obligation of public benefit on charities includes a responsibility to consider major public ills and threats to society and the environment beyond the specifics of the charity's own objectives. We consider the climate and biodiversity emergencies and the widespread public desire to build back better in response to the coronavirus pandemic to fall into this category.

d. High impact social investments: We are enthusiastic about investments in entities created for the purpose of addressing pressing social or environmental problems although in our case we don't envisage being able to identify any that directly address our particular charitable objects. In those cases where such investments also come with below market rate returns we wouldn't generally invest our growth portfolio in them, but we are open to considering them as a small part or as a source of uncorrelated risk/return within a wider portfolio.

e. Engagement and stewardship: We expect our managers to be able to demonstrate clear engagement and stewardship plans advancing the Paris Agreement, the SDGs and the build back better agenda. We also expect them to have a clear analysis of systemic risks that relate to any charitable objective or public benefit more generally as part of their stewardship activity combined with plans to act with others to address the risks they have identified. We expect them to take advantage of engagement activities created by our own work and to be open with others about their plans and progress.

f. ESG integration: With the growth that we observe in our work in the understanding of the value of taking account of ESG factors in optimising risk and return in investment portfolios we look to our managers to be able to give a good account of the integration of ESG factors in their work. We expect well developed models, taking advantage of the insights of charities and NGOs generally, and including those areas in which we work. We are looking for clarity about how ESG factors affect valuations or decisions to buy, sell or hold individual assets as part of giving us confidence in the ability of the manager to manage our portfolio successfully for the long-term.

> “Our advice to charities is often to start with the basics”

Our approach is not a one-size-fits-all of course. But the general principles we consider provide a useful framework.

ASK MORE QUESTIONS OF YOUR CURRENT PROVIDERS

Once the conversations about responsible, sustainable and/or impact investment start it can feel daunting, and complicated. Our advice to charities is often to start with the basics and that can be as simple as asking more questions of your current advisers and/or providers. If jargon or lengthy explanations are hard to understand, ask for the information to be explained in a different way, and don't be afraid to ask for information specific to your requirements. If every charity started to ask for clearer, more robust information about how their money is being used in ways that align with organisational mission and values (regardless of what is or isn't specifically included in their responsible investment policy if they have one), the effect would be considerable and encourage those financial institutions that are lagging behind the leaders, to improve more rapidly.

Considering the responsible investment policies and practices of the pooled funds in your charity's portfolio and assessing whether they reflect best practice is another obvious starting point. The EIRIS Foundation's report on charity-specific pooled funds that was published in 2021 concluded that “the majority of charity pooled funds are not moving with the times”. Thinking around environmental and social issues and how they are incorporated into investment and business decisions has changed but many pooled funds, including ones only open to charity investors, do not reflect this. On the other hand, some pooled funds now have a proven track record of delivering both returns and robust responsible investment. This may seem incredibly obvious but why wouldn't charities choose the options that incorporate both?

LEARN FROM OTHER ORGANISATIONS

One of the benefits of heightened interest and demand for responsible investment is the wealth of resources and useful case studies now available for those looking for more information. In the simplest terms, if other charities are successfully adopting robust, demonstrably impactful responsible and sustainable investment strategies without financial detriment, why wouldn't this approach be adopted by all charities in a position to do so? Learning from other organisations and using objective resources produced by, amongst others, the EIRIS Foundation, Friends Provident Foundation, ShareAction, the Association of Charitable Foundations, the Impact Investment Institute and UKSIF, can help those charities looking for their own way forward.

Charities already have many of the tools they need in order to be a huge part of the shift the finance system must make to become one that best serves people and planet. In this critical decade for the climate emergency and social change, no charity can afford not to be part of this movement. ●

How charities can use their assets to vote for change

Responsible investment is not just about what you invest but how you vote to influence the firms that you invest in, says Katie Stewart

"ONLY A FIFTH OF THESE SOCIAL AND ENVIRONMENTAL RESOLUTIONS ACTUALLY PASSED LAST YEAR"

Katie Stewart *is senior research officer at ShareAction*

AS A social change organisation, the Joseph Rowntree Foundation (JRF) encourages its fund managers to integrate environmental and social issues into their investment analysis and decision-making processes. So it came as a shock to find out that one of their asset managers had voted against human rights proposals at two major weapons manufacturers at the 2021 company AGMs.

While JRF does not have holdings in these companies in its portfolios, in accordance with its ethical investment policy, it was nonetheless alarmed to hear this. This illustrates a concerning trend: that while charities may have clear expectations for their investments, many have limited visibility over their fund managers' firmwide voting decisions.

Using invested assets to vote at company AGMs can be a hugely influential tool to pressure companies to stop harmful practices and improve environmental and social performance. As we go into the 2022 AGM season, many companies will be facing shareholder resolutions which aim to directly impact charities' objectives, such as human and labour rights, climate breakdown, and social inequality. Dedicated resolutions aside, voting against director re-election, compensation, climate strategies and financial statements can be a powerful signal of dissatisfaction with company "business as usual".

Most charities, of course, don't pick shares directly: allocation is managed by asset managers, who then vote on behalf of all their clients' assets. However, from our experience coordinating the Charities Responsible Investment Network (CRIN), we've often found that charities have limited visibility on how their asset managers are using their shares in practice.

> "Seven asset managers voted on fewer than 60% of resolutions"

So how are asset managers voting in practice on environmental and social resolutions at company AGMs? As it turns out: often poorly. And what can you – as a charity asset owner – do about it? As it turns out: quite a lot.

PERFORMANCE VARIES WIDELY…

To look at how asset managers are voting in practice, ShareAction analysed the 2021 voting decisions for 65 of the world's largest asset managers to look at how they voted across 146 environmental or social resolutions at company AGMs.

To start with, voting performance varied hugely between asset managers in our sample. While the top 10 performers voted "for" over 90% of sampled environmental and social resolutions, the lowest five performers voted "for" less than 30%. The lowest three voted "for" fewer than 1%.

And that's if they vote at all. Seven asset managers voted on fewer than 60% of resolutions – sending a signal to these companies that their behaviour on environmental and social issues is not of interest to their shareholders.

Having a predominantly "passive" investment approach is no excuse. Legal & General, the eighth largest asset manager in our sample, has a "passive" focus but still voted in favour of 77% of shareholder proposals.

Do charity managers fare better? We compared the results to a smaller sample of 15 asset managers used by members of our Charities Responsible Investment Network (CRIN) and our Responsible Investment Network – Universities (RINU). This group of asset managers performed slightly better on average, with a median of 73% "for" votes, compared to 61% for the larger sample. However, even this group varied widely, with the lowest ranked supporting just 60% of environmental resolutions and 24% of social resolutions. This leaves a lot of room for improvement.

…MEANING MANY RESOLUTIONS FAIL TO GARNER SUPPORT

Ultimately, only a fifth of these social and environmental resolutions actually passed last year. Those that failed to reach this threshold included resolutions on reporting ▸ p56

The journey to net zero

RORIE EVANS

Client Director – Newton Investment Management

Focus on climate change and net-zero obligations continues to intensify

What key developments are you seeing in relation to net-zero?

The climate crisis is an issue that clearly presents financial risks and opportunities, but also threatens the climatic stability that has enabled modern life as we know it. The sixth Intergovernmental Panel on Climate Change (IPCC) report published in August 2021 provided an update on the latest scientific data regarding climate change. This has been described as a "code red for humanity", indicating that we have reached a critical point at which urgent reductions in absolute greenhouse-gas emissions are needed to avoid potentially devastating consequences for the health of the planet.

A common set of standards on climate reporting is now emerging, and these provide crucial guidance for asset owners and managers. We recognise that they are in their first iteration; the standards are likely to evolve, requiring an adaptive approach to modelling and reporting of climate-related risks, opportunities and impacts.

We have taken part in the Institutional Investors Group on Climate Change (IIGCC) target-setting groups to ensure that the guidance standards are robust and practical to implement, and have participated in consultations on target setting. We have also conducted meetings with organisations that determine and audit science-based targets, which has assisted us in building our understanding of what the broader industry is doing.

What is Newton's net-zero approach?

The key principle at the core of Newton's approach is to manage for real-world change. We will seek to manage for better climate outcomes, even if individual climate measures appear worse in the short term. For instance, investing in and engaging with a heavily emitting utility and encouraging it to adopt a decarbonisation strategy could be more beneficial for the climate than exiting sectors that will continue to be crucial in meeting our energy needs. Our central aim is not to transition our portfolios; we want the real economy to decarbonise.

In addition, we are committed to evolving existing portfolios, and developing new strategies, to manage the long-term risks and opportunities associated with the transition to a low-carbon world. Identifying the winners of this transition will require deep fundamental research to better understand the influence of this transition on business and economic models.

While it is important to actively manage the risk of stranded physical assets and business models, there will also be a myriad of new investment opportunities aligned to delivering the products and services needed to enable a successful energy transition. Our longstanding thematic approach to investing is an important pillar in understanding where in the value chain climate-related opportunities can be best identified.

Finally, our approach will involve the comparison of our portfolios against a hypothetical Paris-aligned

NEWTON
Investment Management

What we do

At Newton Investment Management, our purpose is to help our charity clients fulfil theirs. We are a trusted long-term partner to charities, and have a strong track record of supporting them in achieving their goals through active, thematic and engaged investment. We manage a range of strategies for charities, including charity-focused pooled funds, sustainable funds, and segregated portfolios. We invest in a way that seeks to deliver attractive outcomes to our clients, and helps foster a healthy and vibrant world for all. And we do not stand still. Innovation is a fundamental part of our service to charities.

FAST FACTS

- Four decades of global investment experience, with particular expertise in absolute-return, income-focused, high-conviction and sustainable investing
- Clients include charities, pension funds, corporations and, via our parent company BNY Mellon, individuals
- ESG analysis fully integrated into our core investment process

global economy. As a first iteration, we will compare our portfolios' emissions intensity against their respective benchmarks, having applied an annualised reducing-balance percentage reduction of 7% (this percentage is sourced from an emerging consensus from industry reports).

How can Newton help clients on the journey to net-zero?

It is crucial that Newton has a consistent and rigorous core approach to net-zero, but equally that it can adapt to, and work with, individual clients on their own net-zero journeys. We will evolve our approach over time as science, policy responses, management approaches and client needs progress. Active management is a dynamic process where the aim is to navigate client portfolios through an ever-evolving landscape of opportunity and risk.

We have seen that for some clients, their net-zero path has required the need for divestment strategies (from heavily emitting companies, for example), and we have launched a range of sustainable strategies which embrace stricter carbon standards. We will continue to be flexible and work with clients on their journeys.

How do you see your approach evolving?

While we are pleased with our progress thus far, we are still in the process of refining our plans, none of which are completely formalised. It is easy to make commitments, but backing them up over the long term with subject-matter expertise, technology and cultural buy-in are crucial to ensure longevity.

In March 2021, Newton Investment Management Ltd joined the Net Zero Asset Managers initiative, which comprises a group of asset managers who are committed to supporting the goal of net-zero greenhouse-gas emissions by 2050 or sooner. As the transition to a low-carbon world continues to gain traction, we are committed to supporting this goal, and we will continue to adapt to the complex and evolving investment landscape.

> “We have launched a range of sustainable strategies which embrace stricter carbon standards”

rationales for the pricing of Covid-19 vaccines at Johnson & Johnson; assessing the impact of stronger measures to control disinformation at Facebook; conducting a report on human rights due diligence at Lockheed Martin; and undertaking a racial equity audit at Citigroup bank.

Indeed, we found 18 ESG resolutions that would have been successful if just one of the world's three largest asset managers at the time of the study's publication had voted in favour. These included proposals on tobacco marketing to underage consumers; environmental pollution; climate-related lobbying; and diversity and inclusion.

Notably, social resolutions got less support than environmental ones: around one in three environmental resolutions passed compared to just 15% of social resolutions. Disclosure-related resolutions on diversity received significantly higher levels of support than other resolutions with a stronger focus on action or changing corporate behaviour, which struggled to get support.

IMPROVING PERFORMANCE

Let's be honest: this isn't great. While some asset managers are using their votes to drive environmental and social change at investee companies, or even co-filing resolutions themselves, others are voting down resolutions – or not voting at all.

As asset owners, charities are in a strong position to influence their asset managers to support environmental and social resolutions at company AGMs. Proxy voting is complex, and it can be difficult to know where to start – but here are three simple steps you can take to engage your manager.

First and foremost: transparency is key to accountability – so make sure your manager is reporting on their voting decisions.

If they don't publish voting records, ask them to disclose these publicly – and include rationales for any votes against environmental or social resolutions. In a 2020 study on practices by 75 top asset managers, ShareAction found that publishing proxy voting records is becoming more widespread, with 55% of our sample disclosing a record of proxy votes cast in AGMs. However, only 17% published rationales for their voting decisions – so there's still a lot to do.

Secondly: ask to see their voting principles – and ask for detail where voting policies are lacking.

A large asset manager can vote thousands of times during an AGM season, so having a clear indication of the principles they use to cast their votes on ESG issues is an important way of making this accessible to clients. However, our research has found that the majority of top asset managers' voting policies have no specific commitments with regard to shareholder proposals on climate, human and labour rights, and biodiversity.

> “Ask your asset manager to disclose their performance”

So, ask them: do they support environmental and social resolutions on a comply or explain basis? Does their policy contain detail on how they will typically vote on resolutions relating to climate, biodiversity, human and labour rights, equality and inclusion, political donations, and other areas of interest to your charity?

You may also want to tell your asset manager how you'd like them to vote on certain issues. If you have a bespoke or segregated mandate with your manager(s), you can generally direct your voting yourself by setting a voting policy; if you are in a pooled fund, you can set an “expression of wish”, setting out what you'd ideally want to see in voting policy and approach.

As Colin Baines, investment engagement manager at Friends Provident Foundation, noted: “We set out our expectations to our manager using our investment policies and the minimum standards identified in our ESG Olympics State of the Sector Report 2020. Following positive engagement, they have now introduced a formal policy to vote in favour of all ESG resolutions, taking a ‘support or explain’ approach, and adopted a new engagement escalation policy to vote against management where there is a lack of progress.”

Thirdly: monitor their performance and hold them to account.

We admit: with the exception of ShareAction's research team, no-one is eager to spend their time picking through dozens of voting decisions. Voting records can run to dozens of pages: it's difficult to know where to start.

However, you can ask your asset manager to disclose their performance on specific types of resolution, such as climate change or political donations – or key ESG votes. For example, ShareAction publishes an annual list of Resolutions to Watch, which features key social and environmental resolutions that are coming up at big companies in the coming AGM season. This year, we're highlighting resolutions focusing on fossil fuel financing, paid sick leave for US workers, preventing forced labour in supply chains, and the public health costs of limiting access to Covid-19 vaccines, among others.

You can also use our voting research to see how your asset manager ranks on voting performance compared to their peers. And if they're falling short – ask them why.

And, for the more enthusiastic: co-file a shareholder resolution yourself!

Whether it's forcing public health disclosures at food and drink manufacturers, asking businesses to pay their staff a living wage, or putting climate on the agenda for big banks, many charitable investors have joined ShareAction or other NGOs to co-file resolutions in line with their mission. You may be able to use your existing shares in companies through your asset manager, or some charities just buy a direct share to participate. We won't lie, it can be a complex process – but there's a lot of support and guidance out there to help you do it. As Jonathan Levy, investment portfolio manager at the Joseph Rowntree Foundation told us: “We have recently co-filed our first resolution and it feels great to use our assets to drive social change in line with our mission – instead of just letting them quietly sit in the bank.”

At the end of the day, you own these companies, so make your votes count. ●

Using social impact investment to further the mission of charities

Social impact investment is one way that charities can use their investments to further their charitable aims, says Amir Rizwan

"SOCIAL IMPACT INVESTMENT HAS BEEN INCREASINGLY USED BY CHARITABLE TRUSTS AND FOUNDATIONS FOR THE PAST 20 YEARS"

Amir Rizwan
is relationship director at Big Society Capital

CHARITIES HAVE long played an important role in maintaining the social fabric of the UK – one which has become even more critical as the devastating effects of the pandemic play out. For charities that have large reserves, which in some cases are allocated into investments designed to generate a return, there is a growing opportunity to think strategically about how these investments can contribute towards their social mission.

The way in which charities interact with investment has changed over the three decades since the Bishop of Oxford case in 1992. The case – which aimed to limit the Church of England's investment into organisations that supported the apartheid regime playing out in South Africa – brought attention to the ethical considerations of charity trustees for the first time. It continues to be a hotly debated area; demonstrated most recently by the Charity Commission consultation process on responsible investment (RI). This asked trustees, charity investment managers, employees and others to share their thoughts on whether trustees should be responsible for ensuring that the investments they hold are consistent with their charitable aims.

There can be a lot of confusion, jargon and complexity about how charities might align their investments with social impact. This can come from the fact that the idea of social impact in relation to investments is a topic that is new for some; while for others there may not be a good understanding of the different tools and mechanisms that exist. This can then lead to scenarios whereby investment decisions that are made by charities using their reserves are delegated to mainstream fund managers or advisers whose core aim is to maximise financial returns, without any real consideration of social impact.

> "The way charities interact with investment has changed"

However, is this the optimum way of working for charities? There now appear to be a growing number of charities that are looking at how their reserves can play a role in furthering their objectives – a shift which has never been more needed as UK social inequalities deepen.

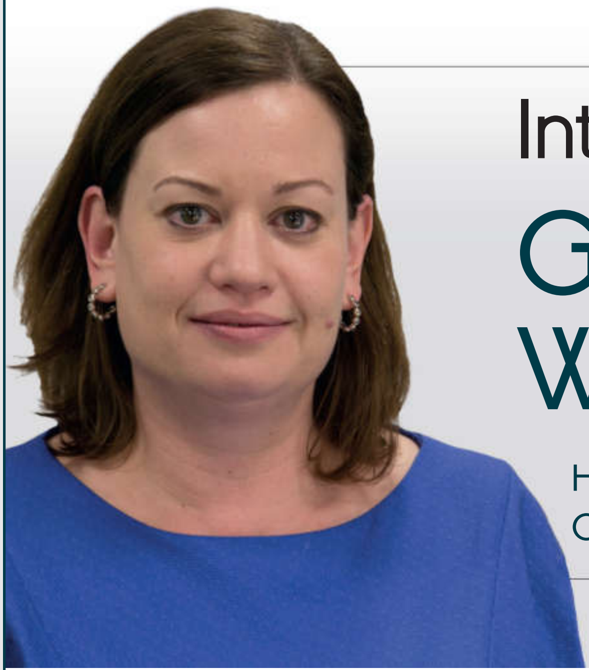
HOW SOCIAL IMPACT INVESTMENT CAN BE USED BY CHARITIES

An area of opportunity for charity finance managers to consider when it comes to new ways of using their reserves is the growing social impact investment market here in the UK. Social impact investment is the use of finance to achieve a social as well as financial return. It is an approach to funding which offers a spectrum of choices and approaches and can provide an opportunity for charities to think about new ways in which they can better use their reserves to align more deeply with their mission while still generating a financial return. Here at Big Society Capital we were set up to improve people's lives in the UK through social impact investment. Our latest market sizing report illustrates that social impact investment in the UK has increased almost eight-fold over nine years: from £833m in 2011, to £6.4bn in 2020. And this looks set to continue growing over the coming decades – our aim is to see that number at least double by 2025.

This area may seem novel for charities; however social impact investment has been increasingly used by charitable trusts and foundations for the past 20 years, often from carve-outs from their main endowment. The spectrum of approaches can differ, and it is worth understanding that it can sometimes be a slow process; however, it is one that could provide a real opportunity for charities looking to create an impact with their finances.

There are two main ways for charity finance managers to approach social impact investment: mission-related investments and investments into impact funds that may not necessarily align with their mission.

1. Mission-related investments: Mission-related investments are investments that directly link to ▶ p62



Interview with GEMMA WOODWARD

Head of Responsible Investment – Quilter Cheviot Investment Management

Jargon and ratings oversimplify meaningful responsible investment

From exclusionary screening to SDGs, the world of responsible investment is awash with jargon, buzzwords and acronyms. One of the worst offenders, according to Quilter Cheviot Investment Management's head of responsible investment, Gemma Woodward, is the blanket use of ESG (environmental, social and governance). "It has become a catch-all term that oversimplifies the complexities of ethical investment," she says. "People have become lazy about what ESG actually means and how it is used. When people talk about an ESG company or an ESG fund, what do they actually mean? Are we just ticking some random boxes?"

> "We need to get so much smarter and precise about our language"

When thinking about ESG factors as part of the whole responsible investment process, it's not just environmental, social and governance, Woodward argues. "You've got stewardship and integration. You've got screening, sustainable and impact investing, and other broad categories. But ESG has just become shorthand for all of this. This is where misconceptions and misunderstandings occur, because what you think as being appropriate for your requirements from a responsible investment perspective are distilled down to this one term. If you call something an ESG fund, it could be doing a whole variety of different things. The term is too basic."

Ultimately, it is clients – charities and their trustees – that will struggle, says Woodward. "It gets more difficult for the end consumer to know what they should want. What are they supposed to be looking for?"

Woodward says she is not alone in this thinking and that the more experience you have in the sector, the more you become aware that this type of blanket term fails to appreciate the nuances involved. "There have been many iterations of responsible investment. If you are new to it, then 'ESG' is the kind of thing that captures the imagination. But often the end consumer still doesn't know what it means. We need to get so much smarter and precise about our language."

ENGAGEMENT AND AWARENESS

In a recent survey of its client base, Quilter Cheviot found that respondents consider stakeholder voting and corporate engagement as low on the scale when it comes to key priorities of responsible investing. This highlights a misconception of how the industry operates

What we do

Quilter Cheviot is a leading investment management company specialising in helping charities and private clients with their investments. The ethos of our business is built on the premise that 'the people you meet are the people managing your money'. This is to ensure that the discussion we have with clients and the implementation of the charity's investment strategy is seamless.

We offer charities a number of different approaches to responsible investment including stewardship, ESG screening and ESG integration. Additionally, we have a strong educational programme which covers a wide range of investment and non-investment topics.

QUILTER CHEVIOT
INVESTMENT MANAGEMENT

FAST FACTS

- Established 1771
- Won more than 20 awards in the last two years
- Gained 5* ratings Defaqto every year for the past six years

*All figures as at 1 March 2022

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and the goals it is trying to achieve, says Woodward. "The engagement aspect of what we do is incredibly important, but that is not necessarily how it gets portrayed by the industry because it is long-term, complex and cannot be put in a nice little box or summed up in a neat little phrase. The financial services sector has become very lazy in explaining what it is we do and our purpose."

So, what efforts are being made to address this? Internally, Quilter (Quilter Cheviot's parent company) is looking at the terminology it uses, and refining its language. "We are going through that process," says Woodward. "But it is hard to standardise the language across the entire organisation."

The investment management company will be engaging with its clients over the next two years, and on an ongoing basis, to determine more clearly their responsible investment preferences, and what they want to achieve. This will not only help Quilter Cheviot to gain insight, but it will also increase awareness and understanding among clients of what is involved in meaningful responsible investing.

Woodward explains: "This is not just about taking into account ethical considerations or positive inclusions, which we have always done as part of our sustainable investment strategy, but this is a way of laying out our stewardship approach to our clients and integrating ESG factors within the investment process."

EXPECTATIONS AND RATINGS

Another area that Woodward believes over simplifies responsible investment is expectations around fund ratings. "If an investment manager uses one external data provider, often it will have inherent biases. It will look through your portfolio and chuck out a number or letter based on sustainability, which will almost certainly be better than the benchmark. But that rating is literally based on that provider's data; it doesn't take into account any other research."

> "The engagement aspect of what we do is incredibly important"

To combat this, Quilter Cheviot uses multiple data providers and has its own research teams, which are charged with considering ESG factors within the investment process. This takes into account aspects such as voting, qualitative assessments and quantitative data dashboards. "We don't want to just give clients a number; it is too simplistic because it does not take into account the many aspects of stewardship. A number may make you feel good that you are beating a benchmark, but it is not a true reflection of what is going on and is meaningless."

Interview with JAMES CORAH

Head of Sustainability – CCLA Investment Management Ltd

You have to face up to the problems of the real world to make real-world change

"Environmental, social and governance (ESG) investing is becoming really focused on metrics and numbers, policy and process," says head of sustainability at CCLA Investment Management Ltd, James Corah. "We are forgetting what is really important from a real-world perspective.

> "The power for charities to push everyone in the right direction is huge"

And when you look at the power that the investment industry actually has, as the owners of the capital, it is not really using it properly yet. The power for charities and organisations that care about change to push everyone in the right direction is huge."

An archetypal example of this lack of real-world application is the perpetuation in society of modern slavery. An estimated 40 million people are trapped in a state of slavery, ranging from debt bondage to forced marriage to human trafficking and prostitution. And it touches all of our lives. The Ashridge Hult Business School ran an anonymised survey of UK retailers and found that 77% believed slavery exists in their supply chain somewhere, despite policy and public statements denouncing such practices.

Corah says: "Everyone in the industry is talking about slavery and human rights as being important, but we have found that very few businesses have created a really concerted effort to try to drive change. We have seen a lot of great policies and processes being created – more and more shiny modern slavery reports. But on the back of this work, very few organisations have said what they have found or what they have done about it."

BREAKING DOWN BARRIERS

According to Corah, there are three main structural barriers to tackling this problem. The first is regulatory. He explains: "The Modern Slavery Act is great. It really was a world-leading piece of legislation when it came in. But it doesn't have any teeth to it, and it definitely doesn't have huge incentives. So there's not really a regulatory carrot or stick to make it work when it comes to enforcement."

Another barrier is potential reputational damage for those companies that are looking to uncover instances of modern slavery within their operations. The likelihood is that any revelations will not play out well in the media. "When you see companies associated with modern slavery it is always negative, even when they have found it," says Corah. "It is not a positive media environment and although that may be right and expected, it doesn't create the kind of culture that allows companies to be open and honest."

The other element is a lack of motivation among owners to discover problems. "As owners of these companies, the investment industry hasn't really pushed for businesses to do the right thing," says Corah. "In fact, quite the opposite. Often they don't want you to find any problems, because they don't want to be associated with them. There is also the fear that your investors are going to run away at any sign of a problem."

ENGAGING VERSUS DIVESTING

In order to make real change, says Corah, simply walking away is not a solution. "In the past, if you found a company had problems, you would divest, and that is not really helpful. What we have got to do is build an open and supportive conversation."

To this end, CCLA created a modern slavery programme, backed by CEO Peter Hugh Smith as patron. The project looks at how CCLA can support the companies in which it invests on their journey to eradicate modern slavery from every part of their supply chain.

Corah explains: "We can say to a company that we think slavery exists in its supply chain somewhere and maybe we should be looking at it in a more human-centric way. The whole programme is designed to look at things differently and take companies through that journey. If you find problems, what have you done to remedy it? How have you supported victims? How can you prevent it happening again? If the conversations are open and honest, you will have a much more positive outcome for everyone."

With a support network offered by the investor, the companies themselves are beginning to be bolder and more proactive, says Corah. "We have found that companies have been hugely welcoming and want to make the necessary changes. Knowing that we will not drop them at the first sign of trouble gives them confidence to push forward the necessary processes and not be fearful of looking for problems."

> "There's been a collective embracing of what we are trying to do"

Corah is optimistic but says there is a still a long way to go. "Obviously, different companies are at different stages on that journey. But there's been a collective embracing of what we are trying to do and accepting the world for what it is. That's allowing us to make change happen, rather than pretending we live in a world where everyone is free and happy in our supply chain."

an organisation's charitable objectives. These can come in many forms; such as directly providing a loan to a social enterprise or investing into a social impact investment fund.

The investments made using this approach are expected to generate a financial return, although funding may or may not be provided on commercial terms. They are often used as a tool by trusts and foundations to develop new ways to achieve their social mission. To bring this to life I have provided three examples below of how this can work in practice for charities:

- **Comic Relief** – through a dedicated social investment fund called Red Shed set up in-house, Comic Relief pooled £6.5m of its reserves to go towards testing new financing models that use repayable finance structures. All of the structures that Comic Relief supports with this money must align with its social mission – which is to end world poverty. Over the past three years, Comic Relief has made over £4m of these investments; including providing an interest-free loan to refugee charity RefuAid and providing a loan to BEAM, a social enterprise that supports homeless people into employment.

- **Bank Workers Charity** – since 2013 the charity – which gives advice and support to members of the banking community – has made £2.8m of social impact investments after allocating £3m of its funds to go towards this. Most of Bank Workers Charity's income derives from its investments, and it uses returns to support its charitable activities. Again, these investments align with the charity's mission. For example, it has made an equity investment into social lender Charity Bank and a loan investment into Great Western Credit Union.

- **Crisis** –The national homelessness charity launched the Venture Studio from Crisis in November 2020 to create, grow and invest in businesses that accelerate the end of homelessness. The studio invests in early-stage ventures that can make an impact on ending homelessness at scale. The studio made three investments in its first year and is currently finalising its second round of investments. Crisis has already received funding from players of People's Postcode Lottery and visionary philanthropists to support the Studio. It is now exploring how Crisis's commitment to the Venture Studio can be used to encourage further financial support.

These three examples demonstrate the range of options that are available when it comes to using mission-related investments and how they can meet the objective of providing charities with returns that they can then use to support their social mission.

2. Investments into impact funds

Charities can also make investments into impact funds that may not directly link to their mission. Often these funds can be thematic in nature and work by pooling investment that is then used to support a particular impact thesis. An example of this is the Women in Safe Homes fund. Launched by Resonance, the fund supports women's sector organisations in accessing capital to acquire housing that can be used to support women who are at risk of homelessness, often fleeing domestic abuse. Funds such as these operate as "private market" funds which means that there aren't sufficient levels of liquidity, making them challenging for some charities to invest in.

> "Does your charity have a responsible investment policy?"

At Big Society Capital we looked to address the challenge of liquidity and access to private market impact investments by setting up the Schroder BSC Social Impact Trust, which we believe to be the first social impact investment product to be listed on a stock exchange. This fund was set up in 2020 by Big Society Capital and Schroders, and aims to direct private capital into proven investment models addressing some of the UK's most pressing social challenges – including rough sleeping and education. The trust provides investors with exposure to hard-to-access private market impact investments, within a diversified portfolio providing sustainable returns, demonstrable local UK social impact and a low correlation to traditional financial markets.

WHAT YOU CAN DO NEXT

Charities face multiple challenges because of Covid-19 which has impacted their reserves while at the same time increased the demand for their services. Under these increasing pressures, charity finance managers may feel that considering new investment strategies seems even more challenging. However, for those that can, this route can offer an interesting solution to the challenge of how charities can better align their investments towards their social mission.

There are a number of questions you can ask to help you better understand what this all means for your charity. Firstly, does your charity have a responsible investment policy and has this been discussed at the trustee level? Secondly, if you work with a financial adviser or manager, have you spoken to them about the composition of your investment portfolio and how it aligns to impact?

Finally, it may make sense for you to read more about the case studies above as well as speak with peers in the trust and foundation space about how they have been doing this. We at Big Society Capital have a dedicated investor engagement team that works with multiple investor audiences around how they can better understand impact investing and the role it can play for their organisation. We can answer questions you may have on this topic, remove the jargon and complexity as well as introduce you to peers or organisations that can help you better understand how social impact investment can play a role in your organisation. With all the recent changes in guidance and the ongoing challenges we face as a society it is clear that this is only the start of the discussion. ●

Climbing the ladder to a net-zero investment portfolio

Last year, Wellcome adopted a net-zero plan for its investment portfolio. Elaina Elzinga *outlines how it plans to achieve this*

"ACHIEVING NET-ZERO ACROSS OUR PORTFOLIO WILL BE ONE OF THE MOST SIGNIFICANT CHALLENGES FACED IN MY CAREER"

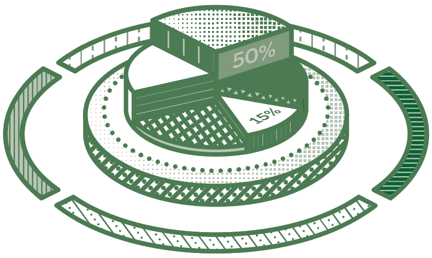
Elaina Elzinga *is investments principal, head of absolute return and climate lead at Wellcome*

CLIMATE CHANGE is already having a major impact on the health of people around the world through rising temperatures and extreme weather events.

We have seen spikes in water-borne diseases during the floods in South Sudan, higher temperatures causing premature births in Australia and a bread crisis in Syria caused by failing crops as well as the ongoing conflict, to cite just a few examples. Almost every statistic on climate change and its effect on our planet translates into a health story.

Climate change and health is therefore a strategic priority for us. It is one of the major health challenges we want to help solve over the coming years – alongside mental health and infectious disease – by backing science-based research into how we can mitigate the health effects of climate change.

As one of the world's largest charitable endowments, spending around £1bn annually on new discoveries in life, health, and wellbeing, we're acutely aware of our responsibility to invest sustainably, in every sense of the word. We're also conscious of the power that comes with a £38bn investment portfolio. We have an opportunity to influence companies to make real changes to what they do.



Last summer we pledged that our investment portfolio, which encompasses public equities, hedge funds, private equity and property, will become carbon net-zero by 2050 at the latest. It's easy to make such a pledge, but we are aware that the hard work will come as we progress towards making it happen. To hold ourselves to account and in the hope that it helps inspire others, we've published our strategy for turning that commitment into reality – you can find it at https://bit.ly/3rEUPJA.

> “ Our net-zero strategy is all about engagement ”

STARTING POINT

At its heart, our net-zero strategy is all about engagement. We believe that influencing the companies we invest in will enable us to drive real-world change in reducing carbon emissions. We are prompting the managers of companies within our portfolio to adopt a net-zero strategy, using science-based targets, the gold standard in carbon measurement and reduction. Step by step, as each business delivers on this, we will have achieved our goal to decarbonise our portfolio.

This approach is a continuation of what Wellcome's investment team already does every day. We assess the social licence to operate of each company and investment partner that we invest in, ensuring that they maintain good relations with all their stakeholders and that they uphold the strongest standards in considering their impact on the environment and communities. This is not only the right thing for us to do, but it also makes sense from an investment perspective. Companies that are responsive to a changing world should generate stronger financial returns over time.

We're starting from a relatively strong position in aiming for net-zero as our portfolio already has a comparatively low carbon footprint. An external analysis showed that the carbon footprint of Wellcome's public equity holdings is less than 30% of the relevant global benchmark, and we already have relatively little exposure to the most carbon-intensive sectors.

We are encouraging companies to follow Task Force on Climate-related Financial Disclosures recommendations, the global standard for climate-related disclosure. We joined the Institutional Investors Group on Climate Change to help us influence companies as well as encourage the development of quality emissions reporting standards.

Household-name companies have often been the focus of attention when it comes to calls for greater climate action. We've found that ▶ *p68*

Interview with

MATT CROSSMAN

Stewardship Director – Rathbones

ANDREW PITT

Head of Charities – Rathbones

Governments and investors play key roles in delivering COP26 net-zero commitments

For those looking for radical action on climate change, COP26 might have seemed a little underwhelming. However, stewardship director at Rathbones, Matt Crossman, believes there is some cause for optimism. "The scale of activity at COP26 was pretty mind blowing. Glasgow hosted a staggering 38,000 delegates from 197 countries," he says. "Now the dust has settled, we can reflect on the relative success of the event, which did bring some headline agreements to give us a glimmer of hope for the future."

> "By the end of COP26, there were 140 countries signed up to the net-zero pledge"

Crossman says it is worth taking a step back to look at what has been achieved so far through COP. "Back in 2015, only 127 countries had made any kind of mid-century net-zero commitment. By the end of COP26, there were 140 countries signed up to the net-zero pledge, including India and China, accounting for 90% of global emissions. Is it fast enough? Probably not, but it is significant."

Crossman says that the onus is now on governments to follow through with their commitments. "There are still numerous pressing issues for us to address, but we are moving in the right direction. At a national level, governments need to make good their promises to mobilise climate financing – $100bn a year was agreed in Glasgow for climate mitigation and adaptation, and we need to see the phase out of fossil fuel financing accelerate."

ALIGNING VALUES, CREATING IMPACT

For head of charities, Andrew Pitt, investors also have an important role to play in this transition. "There are two main things that all charities need to consider: there's creating impact and there is values alignment. Sometimes I think these two objectives get confused. If you just divest from all fossil fuel companies because you feel they do not align with your values, then that doesn't actually achieve a huge amount in terms of impact."

Pitt suggests working together with companies to reduce their carbon footprint as part of a wider responsible investment strategy. "Obviously, you have to work with companies that are willing to engage, are willing to listen and have signed up to decarbonisation goals. By influencing their choices and helping drive their transition, then you are having much more impact."

He adds that this is a long-term and complex process. "The first thing to understand is that this is not just about some distant net-zero commitment. It is about having genuinely robust plans that impact all of the carbon footprint of the business, and setting interim targets that are tangible. It has to cover the entire emissions profile of the company, not just the direct output. It should include everything from transportation to the footprint of the products it sells."

To achieve the goals set at COP26, charities also have to shoulder some of the responsibility for their own carbon output, says Pitt. "It's not just about their investment portfolios. One of the problems with the environment, social and governance (ESG) movement is that people think that if they have a 'net-zero' portfolio then they are doing all they can. They think the impact they are having on the environment is reflected entirely by the contents of their portfolio. But that's only one part of it. We should all be trying to reduce our personal and organisation's carbon footprints as much possible as well."

FOCUS OF RESPONSIBLE INVESTMENT

How and when change might come about is uncertain, suggests Crossman, and it is important to realise that the pandemic has not fundamentally altered behaviours. "It's pretty clear despite all the talk of building back better, emissions pretty quickly resumed that pre-pandemic path and the trajectory of global warming remains unchanged.

"Having said that, change in society is very rarely linear and predictable. When it happens, it happens rapidly. Just as manufacturers of horse-drawn carriages couldn't have predicted the rise of the motor car, or executives at Blockbuster couldn't have anticipated the rise of Netflix and streaming, change when it comes is usually fast and furious, and led by the private sector where regulation leaves a gap. So, when we reflect on the capacity of our institutions to deliver the change we need, I think it makes the focus of responsible investment all the more important."

> "There is a huge amount of pressure being brought to bear on high-emitting industries"

This gives cause for optimism, believes Pitt. "Behind the scenes, there is a huge amount of pressure being brought to bear by investors on high-emitting industries to change the way they operate. And there is now much more quantitative evidence to suggest that shareholder engagement in its various guises – from formal voting to regular engagement with management – is actually driving this transition. We are seeing major change across the fossil fuel industry as companies look to renewables, cutting emissions and changing their business models. By being stakeholders, charities can be part of that change."

Interview with

STEVEN SOWDEN

Senior Investment Consultant – Mercer

PAUL FLEMING

Head of UK Endowments & Foundations – Mercer

Charities need to consider to what extent all climate crisis scenarios will impact investing

When thinking about the climate crisis there are a number of scenarios that people in all sectors are considering – from a speedy transition to net-zero to global catastrophe, and all points in between. These playbooks can also be applied to your investments and how they are managed.

> “You have to envision how the climate crisis is going to impact your portfolio”

Investment consultant at Mercer, Steven Sowden, explains: “We are working with a number of clients, including charities, to analyse their portfolios against a wide range of potential scenarios to help them understand which investments are exposed to which type of transition risk. We consider scenarios from a rapid transition whereby the world achieves the objective of limiting global warming to 1.5 degrees, to a failed transition where we miss targets and the planet continues to warm at an accelerated rate.”

Both these scenarios, and all those in between, involve risk from an investment point of view.

“In a rapid scenario, the risks are due to the pace of change as businesses quickly act to decarbonise our economy,” continues Sowden. “But of course, with a failed transition, physical risks come to the forefront.”

One of the key reasons for mapping out the worst case scenario is that it provides a justification for having net-zero targets, says Sowden. “We may think that the physical manifestations of climate change that we are seeing today such as wildfires, droughts and polar-ice caps melting won’t have a big impact on the performance of financial portfolios for decades to come, particularly if they are reasonably well diversified. But if the direction of travel stays the same, the meaningful human impact that we are seeing now will be priced into the markets sooner than we think. You have to envision how the climate crisis is going to impact your portfolio, take opportunities that arise, and avoid the risks.”

SUSTAINABLE STRATEGY

This type of longer-term thinking is particularly pertinent to charity investors, who are typically looking for a sustainable strategy that will provide stability for years to come. “Our charity clients intend to be around for decades into the future,” says Sowden. “So it is important to understand the long-term impact of their investments in the context of climate risk.”

What we do

As the trusted advisor to many not-for-profits we are a boutique of experts with the experience to engineer complex solutions designed to meet our clients objectives in today's world. From large foundations to small family-run endowments, we help organisations to meet their investment goals, improve oversight and control, and manage reputational risk. We are backed by the strength of a global organisation, with access to best-in-class investment managers from a range of asset classes. Additionally, our buying power keeps costs competitive. Our combination of boutique advice and global implementation is unique, supporting not-for-profits in meeting their goals no matter what the future brings.

FAST FACTS

- Mercer has advised charities for 45 years
- Globally we advise on $254bn of charity and foundation assets
- Mercer's average UK charity client has £45m of assets
- Mercer's research team employs over 200 people

To have genuine impact, Sowden believes that divestment is not going to be part of the complete solution. "Excluding companies on its own is not going to have a massive impact on decarbonisation. Engaging with carbon-emitting sectors and working with them to change is going to be much more progressive. Divesting has its place, but at some point, you've got to engage and try to change the industries. It's easy to get out of a sector, but it's not going to have much effect on carbon emissions because you have to a degree opted out of the debate."

For Sowden, it is about aligning you investment strategy with the values of your organisation and engaging with the companies you invest in. "By investing there is an opportunity to help reshape the way an industry works. Other companies will see that those organisations that are making efforts to reduce their emissions are receiving more interest from investors. That will force them to change. It's about considering what your aims are as an investor – whether you want to play a role in the transformation of industries on the journey to net-zero or whether you want take a less impactful route."

MERCER'S ROLE

Mercer's role in all this is to provide advice and work with clients to find solutions to achieve their investment aims. "We work with our clients in a range of different ways," says head of UK endowments & foundations, Paul Fleming. "In some cases, we act as an investment consultant, advising the client and helping them appoint a third-party manager. Another way we work with clients is to implement solutions where the clients come to us and essentially treat us more like an investment manager."

> "Advice is what underpins everything we do at Mercer"

So, how does Mercer work with charity clients? Fleming explains: "Advice is what underpins everything we do at Mercer – the ability to administer advice at a highly professional level. So when a charity comes to us and says it wants sustainability and to have an impact, our manager researchers find the best fund manager to administer their sustainability and engagement strategy. We work through a manager selection programme with the client and support charities by implementing solutions directly through a third-party manager. We do a lot of the heavy lifting so that charities get on with doing what they do best, whether that is grant giving or providing services. Fundamentally, what we do is to administer advice so that a charity can achieve its investment and sustainability goals."

those in our portfolio are now very conscious of the need to decarbonise, and it is high priority on boardroom agendas. So, to maximise our impact, we have put emphasis on engaging with our substantial private equity holdings where we believe we can have the greatest influence as conversations about decarbonisation are typically at an earlier stage than in public equity markets. The good news is that these managers are now largely awake to their responsibility to act and are open to learning more about concrete steps they should take.

MAKING A REAL-WORLD DIFFERENCE

It would be possible to get the carbon footprint associated with our portfolio down by selling positions in more carbon-intensive companies. But this would not bring about real-world change.

To deliver an actual reduction in carbon emissions, we believe that it is more impactful to support and encourage companies to make changes to their operations. As a long-term investor, we're in a good position to do this; we can allow companies time to invest intelligently in the changes they need to make. So far, we have largely been met with a very positive response from investment partners and management teams. But if a company continually resists change and does not engage, we will take the view that they do not have a place in our portfolio.

We are ambitious in our desire for change, and we consider 2050 a deadline rather than a target. We have chosen 2050 because we wanted to set a date that is credible, realistic, and that we know we can achieve through measurement, engagement and influence. We will be keeping this under constant review and hope that we will achieve net-zero as early as possible.

It is also prudent to look at the challenges ahead, which will vary by asset class. For example, we would like to improve the energy and thermal efficiency of our large residential estate in South Kensington. But regulations that govern the alteration of heritage buildings currently restrict what we can do.

We recognise that different parts of our portfolio will move at different speeds, but we are committed to encouraging the wide range of companies we invest in to get onto a Paris Climate Accords-aligned trajectory so that we can contribute to a genuine reduction in carbon emissions globally.

> "We consider 2050 as a deadline rather than a target"

TRACKING OUR PROGRESS

We have established best practice criteria for each asset class that we invest in, which feeds into our targeted engagement goals to achieve net-zero. We have set out clear and targeted engagement goals to achieve net-zero. This topic will regularly come up in our conversations with the managers of our assets, including those at the most senior levels.

We internally monitor progress through an "engagement ladder" to track companies' progress. We expect to see our companies moving up this ladder with time:

Step 1: Has the company's management committed to setting a target of net-zero by 2050?
Step 2: Have they set a science-based net-zero target?
Step 3: Do they have a road map to achieve their target, and have interim targets been set?
Step 4: Do they have a long-term strategy and capital allocation plan that is appropriate to achieve these targets?
Step 5: Are interim targets being met?

This is a simple tool but one which allows us an at-a-glance overview of progress within our portfolio, and which provides a pathway to encourage companies along.

SHARING OUR FIGURES

As well as internal monitoring and engagement, we are committed to annually measuring and disclosing our progress. We have created a key metric to measure this – the proportion of our portfolio by value that has a net-zero target. We are reporting both company-declared targets, and independently verified science-based targets. As of December 2021, 23% of our total gross assets have a company-declared target, with 17% having a near-term accredited science-based target. Our strategy should see these figures increase as we work towards our goal.

GOING IN THE RIGHT DIRECTION

I don't believe that there's a perfect or universal way for any asset owner to achieve what we're trying to do, especially as there are many ongoing questions over issues like carbon measurement standards. Everyone will develop strategies that play to their strengths. But the important part is getting going. As global standards and policies evolve, we will move with them, evaluating and fine-tuning our strategy and continuously improving our system. We are committed to holding ourselves accountable, so look out for our public annual reviews. Achieving net-zero across our portfolio will be one of the most significant challenges faced in my career. But I also believe that we have a genuine chance to make a difference. As a responsible investor, the decisions we make now will play a role in protecting the health of future generations from climate change. ●