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Responsible Investment

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Seeking a more meaningful return

The responsible investment world continues to evolve

CharityFinance SUPPLEMENT

The march of responsible investment continues

In the year since our last responsible investment supplement, much has happened on this front – including draft new guidance from the regulator

"THE DRAFT GUIDANCE IS CLEAR THAT TRUSTEES OF ALL CHARITIES CAN DECIDE WHETHER OR NOT TO ADOPT A RESPONSIBLE INVESTMENT APPROACH"

Tristan Blythe
is editor of
Charity Finance

THE PAST year has seen a number of important moments in the responsible investment world. However, some concerns and potential issues still remain.

REGULATORY ACTION

Possibly the most important of these moments for charities is the activity of the Charity Commission, which last month issued draft guidance on responsible investment. The guidance makes clear that trustees of all charities are free to adopt responsible investment practices, and are not required to focus only on maximising financial returns.

However, the regulator's work on this goes back to January 2020 when it asked for opinions from the sector on what was holding some charities back from adopting this kind of approach.

The regulator said that during this initial period of engagement it received over 40 written submissions and had taken part in six roundtables, as well as having direct contact with "sector bodies, trustees, chief executives, investment managers and officials in several government departments and regulators".

> "Some believe the case law is 'outdated'"

In November 2020, it published a blogpost which outlined the main barriers that it had identified from the feedback it received.

Paul Latham, director of communications and policy at the Commission, wrote: "The apparent barriers to making decisions to favour responsible investments fall roughly into two categories: 'in principle' or technical barriers; and those relating to practical issues."

The Commission said that some trustees consider the legal framework to be a technical barrier. Latham said: "There are wide differences in interpretations of the legal framework which clearly breed uncertainty about decisions trustees are legally allowed to make. Some believe the case law is 'outdated' and at odds with public expectations of how charities should behave."

A coalition of charities, which formed in 2019 and has the support of the law firm Bates Wells,

is already seeking a new legal ruling.

A second technical barrier is trustees feeling an "overriding legal duty to maximise the financial returns when investing, regardless of any other consideration", the Commission said.

The third technical barrier is confusion over trustee duties that is created by the Charity Commission itself, including in its main guidance Charities and Investment Matters: A Guide for Trustees (CC14).

Latham writes: "The way responsible investment is outlined in CC14 seems not give some trustees sufficient confidence and assurance that responsible investment is something they can consider, or that the Commission supports.

"In addition, some people highlighted that CC14 lacks practical advice and felt that, given the complexity of the issue, this makes the subject difficult for trustees to navigate."

The blog also lists three practical barriers, the first of which is "insufficient discussion, diversity of thought and robust challenge at trustee boards". This, it argues, restricts innovation and "may also hinder charities having meaningful discussions around responsible investments".

The second is the perception that responsible investment will lead to the sacrifice of investment returns.

And third, "the use of jargon or inconsistent terminology makes it harder for trustees to understand, challenge or hold to account those advising them", Latham writes.

As a result of this work, the Commission says of its new draft guidance: "The draft guidance is clear that trustees of all charities can decide whether or not to adopt a responsible investment approach that reflects the charity's purposes and values, and not just focus on the financial return. The new draft explains that the rules applying to responsible investments are those that apply to all financial investments, including that trustees' decisions must always be made in the best interests of the charity and in line with its governing document.

"The guidance also highlights the slightly different rules that apply when charities invest permanent endowments."

A consultation on the new draft, which takes the form of a short survey, closes on 20 May 2021. You can find out more at https://bit.ly/3wD9FkF.

But the wait for the new guidance isn't stopping charities from taking action. Indeed, research has shown that there are an increasing number of charities taking steps in this area.

The 2020 edition of the Intentional Investing report from investment management firm Cazenove Capital found that 77% of charity investors have decided to adopt a responsible investment policy, compared to 59% in 2015 and 23% a decade ago.

Cazenove found that the most common approach was to exclude investment in certain sectors which are either believed to contradict the specific charity's work or that have a negative impact of wider society. This often includes the tobacco, armaments, pornography, gambling and alcohol industries. However, there has also been an increase in charities seeking to have a positive impact with the assets they choose to invest in.

As well as looking at the prevalence of responsible investment policies, the report also looked at what these were focused on. Around a quarter, 26%, of charities that have such a policy are actively considering the issue of climate change. Furthermore, a third of exclusionary policies prohibit investment in coal and sand tar, and 15% exclude the oil and gas sector. p32

The hidden side of supply chains

BHAVIN SHAH

Charity portfolio manager and manager – Newton Sustainable Growth and Income Fund for Charities

Investor engagement with companies on child labour can help to drive critical change

What is Newton's approach to assessing supply chains?

Supply-chain issues are among a panoply of risks that are unlikely to manifest themselves from an interrogation of a set of financial statements. However, we think they are critical determinants in a company's successful commercial strategy and to achieve the common goals of stakeholders, including shareholders. By integrating our environmental, social and governance (ESG) research into our investment process, we think we improve our chances of arriving at the best overall assessment of the ability of a particular opportunity to succeed for our clients.

Supply-chain issues, including child labour and forced labour (for example with the Uyghur), basic human-rights abuses and the poor management of environmental risks, have the ability to tarnish important brand value, as well as having the potential to cause regulatory issues. We see good behaviour along the supply chain as being consistent with sustainable and ultimately good business.

Looking at this on an issue-driven basis is necessary, and we have policies and thinking established around each of these headline risks. However, consistent with our "bottom-up" approach to selecting stocks, our responsible investment team work with our global industry analysts and portfolio managers to identify the areas of concern in a particular business case, and work with the company where we feel that improvement is desirable.

> "Supply-chain issues have the ability to tarnish brand value"

How does this work in practice?

It's important to recognise that this is an evolving topic, that not all risks are completely resolvable, and that the path to getting better can be a long one.

We think that it is also important to look at the topic constructively, as improvements in company behaviour can be value-accretive. Some companies will put big ticks in certain boxes, while being inherently weaker in others. Understanding what we are trying to achieve at the outset is important.

Samsung SDI is a Korea-based battery maker, and a good example. We identified the company a number of years ago as a potential beneficiary of the adoption of electric vehicles (EVs), and clearly also a business with great potential to assist in the transition to a low-carbon economy. After some issues with batteries supplied for use in mobile phones, one of our responsible investment analysts spent a week in February 2017 touring China and South Korea to look at the battery supply chain. This trip highlighted the problems that were surfacing around the involvement of child labour in cobalt mining. Cobalt is a key resource for batteries, and the complexities of the supply chain mean it is hard to verify the source of production.

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.

Your capital may be at risk. The value of investments and the income from them can fall as well as rise and investors may not get back the original amount invested.

NEWTON
Investment Management

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

How did you engage with Samsung SDI?

The facts around child labour in cobalt are stark, and link directly to the poor economic and security situation in the Democratic Republic of the Congo (DRC). When our analyst highlighted these points to the investment team, it was agreed that this was a material risk for Samsung SDI, and that it needed to be raised with management.

Our initial conversations indicated that Samsung SDI had been fairly active in assessing its involvement with child labour in cobalt and had produced an internal report on the topic. The company agreed to publish this report, and raise the issue's profile.

Samsung SDI explained that it was working via the Responsible Cobalt Initiative (RCI) as the best way to drive real change. For the rest of 2017, our focus was on talking to other companies that were affected and supporting the RCI.

In 2018, we became part of the Principles for Responsible Investment (PRI)-supported Engagement on Responsible Sourcing of Cobalt steering committee with a global coalition of investors. We pushed specifically on the need for a supply-chain audit, as well as the need for surprise audit visits to give credibility to the programme. Samsung SDI has been very active in the RCI, and suggested that the auto manufacturers were the missing link in this work.

We also hosted a conference and have participated in industry initiatives on responsible cobalt, calling for greater action from the industry.

> “There is always more work to do”

What has been the impact of Newton's engagement?

Overall, we believe that Samsung SDI has taken a number of steps that will improve lives in the DRC, and we were particularly impressed when the company announced a joint initiative with BMW Group, BASF SE and Samsung Electronics to launch a cobalt pilot project, with the aim to improve artisanal mining working conditions, as well as living conditions for surrounding communities.

Samsung SDI has also released two supply-chain audits since we began our engagement.

Being a committed, significant shareholder has enabled us to bring our perspectives to bear, and we think this has helped bring forward important change. Good management of these important supply-chain issues enables us to have greater confidence in the company's ability to execute, and should, we think, have a positive impact on its future performance.

This said, we do recognise that, as this example shows, we are often dealing with inherent conflicts, and that when you look deeply into these issues, answers are likely to be imperfect. There is always more work to do.

ENGAGEMENT VERSUS DIVESTMENT

Although exclusion or divestment from areas of concern is a common practice, there are those who argue that this does not go far enough. Instead, they believe a more effective approach is to engage with the companies that you are invested in to improve their behaviour.

However, the two approaches arguably should be seen as complimentary and not a binary choice.

Each charity will have specific "no go" areas that it will not want to invest in, and creating this exclusion list is for many the first step on their responsible investment journey. For some it may be seeing the impact of this on their portfolio and returns that allows them to become comfortable with taking further steps. For others, it may be the first step in an already accepted plan.

The aim of engagement is clearly to effect positive change in the behaviour or the activities of the company invested in. To be successful, a predefined escalation plan and goal is often cited as best practice But, for any engagement to be meaningful, the threat of divestment needs to be real.

A recent example of making this divestment threat real came from the Central Finance Board of the Methodist Church (CFB), which announced in June 2020 that it had sold investments worth over £17m in two major oil companies due to climate change concerns.

The Central Finance Board (CFB) provides investment services to the Methodist Church. It has an in-house investment team which manages a range of funds in support of an ethical stance in accordance with the aims of the Methodist Church.

The divestment of just over £15m in BP and just over £2m in Total was the result of CFB's new analysis of 15 oil companies. The investment team looked at up to 25 different metrics to assess companies' current activities, future investment plans, strategy and governance, contributions to a positive transition, and their track records and targets related to reducing carbon emissions. Companies were given a "traffic-light" rating.

"While BP has recently made a new commitment to reduce Scope 3 carbon emissions by 2050, it has yet to provide details of how this commitment would be met. Total has since made a new emissions commitment," CFB said in a statement. "However, both companies rated amber in the assessment, partly due to their current output and the carbon emissions assessment. ARC Resources, a small holding in the CFB Overseas Fund, was also sold."

The analysis was prompted by a request from the Methodist Conference. The Joint Advisory Committee on the Ethics of Investment (JACEI) was asked to look at the extent to which the business investment plans of oil and gas companies were aligned with the Paris Agreement to keep temperature rises below 2°C.

> " Each charity will have specific 'no go' areas "

JACEI advises the CFB on ethical investment matters, and reports to the Methodist Conference. CFB said that the JACEI report endorses its own analysis.

The move takes the number of oil companies which the CFB excludes from investment to 10 (namely ARC Resources, BP, Chevron, Conoco Philips, EOG Resources, Exxon Mobil, Gazprom, Hess, Total and Woodside). However, the sale does not represent a total divestment from the sector, as, at the time of writing, it still holds four oil companies – ENI, Equinor, Repsol and Royal Dutch Shell.

JACEI has advised the CFB that these four firms have made commitments that implied they were aligned, or close to being aligned, with the Paris Agreement. It advised CFB to engage more with these firms, and will review their progress.

SOCIAL ISSUES

This example concerns environmental action, which is perhaps the area of responsible investment which is most prominent. Yet while it is an important issue and one that should form part of any responsible investment approach, so should wider issues. In particular, the recent ESG Investing Olympics (see pages 46 to 47) found that social aspects are particularly overlooked.

The coronavirus pandemic and the restrictions put in place have highlighted and exacerbated the social inequalities in the UK. One area that gained much attention was the provision of free school meals. There was much criticism of the quality of the food parcels provided by Chartwells, a subsidiary of the Compass Group.

The investment manager CCLA led a coalition of asset owners, asset managers and other finance industry stakeholders in writing an open letter to Compass Group's CEO, Dominic Blakemore. The letter expressed concern in response to reports that the food boxes provided by Chartwells to the most disadvantaged families in the UK were falling short of expectations.

Whilst the outrage on social media, mainstream media coverage and comments from the government, clearly put pressure on the firm, this letter showed that investors could play also play an active role in tackling social issues.

However, letter writing on its own is relatively low-level engagement (although there is no suggestion that in this example the letter would be the sole engagement on the issue). It can be part of engagement policies, but to be most effective needs to be followed up with action, such as meeting with management and voting at AGMs, including against management proposals if needed.

INVESTMENT MANAGERS

Most of the charities which adopt a responsible approach to investments rely on employing investment management firms to carry it out for them, including the engagement elements. And at the same time as the sector's demand for this type of service has increased, the number of investment managers providing a service that claims to be some form of responsible investment has increased.

Unfortunately, this may have added to confusion amongst charities, as different firms will often use different labels for their services, or may use the same term but to mean something slightly different. Hopefully as the services develop and the market matures, uniformity in language will emerge.

Perhaps of more concern is a number of reports that recently indicating that investment managers could be doing better in providing truly responsible investment services.

ShareAction, a charity that encourages investor engagement as a force for good, conducted research into the activities of 37 asset managers making investments on behalf of members of the Charities Responsible Investment Network (CRIN) and the Responsible Investment Network – Universities (RINU). It found that current practice falls short of the CRIN's expectations for managers, which it set out in 2018. Just over half of the group's asset managers (54%) are yet to set any investment targets related to climate change, while just 36% make executive pay conditional upon performance on responsible investment issues.

These issues include the diversity of investors' boardrooms as well as the extent to which they pressure companies to improve their practices through corporate engagement and voting on shareholder resolutions.

ShareAction found that investment managers have made progress on gender diversity, with the average proportion of women on their boards rising to 31% in 2020, up from 23% in 2018. However, this is in stark contrast to their performance on ethnic diversity, with the average proportion of directors of colour remaining stubbornly low at 6%, having increased just one percentage point since 2018.

> “54% are yet to set any targets related to climate change”

On investment managers' voting behaviour, ShareAction found that only 59% publish their voting decisions, while less than half (49%) provided rationales for these decisions.

In separate research, the EIRIS Foundation, a charity focused on promoting and improving responsible investment activities, looked specifically at the responsible investment activities of pooled funds available to charities. Its report, titled Responsible Investment in Charity Pooled Funds 2021, found some improvement but still said that "more needs to be done".

On the positive side, it found that two-thirds of charity-specific pooled funds (67%) screen their investment for more than just tobacco investments, up from 36% in 2013.

However, negative screening policies still mainly focus on so-called sin stocks like tobacco, alcohol, armaments, gambling and pornography, the report said, and funds face growing demands to broaden this list. Furthermore, nearly one in five charity funds don't use any negative screen at all.

A final positive in the research is that the proportion of funds applying positive screens by proactively identifying responsible investment opportunities has grown from 20% to 30% since 2013. ▶ p36

Stewardship and engagement are critical to responsible investing

GEMMA WOODWARD

Executive director and director of responsible investment – Quilter Cheviot Investment Management

ESG factors are firmly on the agenda, but it falls to shareholders to hold companies accountable and ensure targets are met

What is responsible investment?

Responsible investment is about taking into consideration environmental, social and governance (ESG) factors into investment objectives. Recent generations are becoming a lot more conscious and mindful that their investments are not only protected and can accumulate a return over time, but also positively impact society in general.

Responsible investing can be seen as an umbrella term for numerous approaches that can be adopted into strategies. These approaches include stewardship, ESG screening and ESG integration.

Stewardship involves engaging with companies to discuss ESG issues to improve their handling and disclosure of such issues. This may be carried out individually or with other investors. It includes voting on resolutions, either in person or by proxy.

ESG screening involves applying filters to lists of potential investments. This can be based on an investor's ESG preferences, values or ethics. It can also be used to screen out sectors based on perceived long-term viability.

ESG integration is the explicit and systematic inclusion of ESG issues in investment analysis and decisions to better manage risks and improve returns. Examples of this approach could be the inclusion of information into a stock selection or valuation decision.

> "We are now seeing an increased focus on social and governance factors"

What is important to charities in terms of responsible investing in 2021?

Prior to the Covid-19 pandemic, a lot of the focus within ESG was on the "E" – environment. This was driven by a number of factors, but passionate advocates such as Sir David Attenborough and Greta Thunberg have caught the public's attention.

From a charity's perspective, while environmental considerations are equally as important, we are now seeing an increased focus on social and governance factors following how companies responded to the pandemic in 2020. This includes how employees have been treated through their working conditions and how the furlough scheme was utilised for staff.

This can also be viewed from a higher level, such as how dividends and executive pay rises are going to be executed following the company's response to the pandemic, highlighting where their priorities lie. We would liken this to "what did you do during the war?" – companies' behaviour is under the microscope.

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 from Defaqto every year for the past six years

*All figures as at 1 March 2021

How will the UK government approach COP26?

In November, we will see the 2021 United Nations Climate Change Conference (COP26) – the 26th edition of the annual conference – coming to Glasgow. Following Prime Minister Boris Johnson’s comment late last year that he wants the UK to be the “Saudi Arabia of wind power”, we think the UK’s response to climate change in the build up to COP26 will be an interesting one.

We are expecting the National Savings & Investments’ (NS&I) green savings bonds launch later this year. These bonds will help finance projects tackling climate change, particularly around renewable energy. Additionally, the UK government has announced its plans to issue its first green gilts this year to also fund sustainable projects, but this is dependent on the state of the market.

The prime minister plans for a green industrial revolution, but actions speak louder than words. Energy production is a clear priority for the UK, with plans to phase out coal-fired power stations entirely by 2025. We have also seen Drax, one of the UK’s largest electricity providers, have to scrap its plans to build Europe’s largest gas-fired electricity plants due to the large volume of pushback. This raises concerns as to why energy providers are still trying to launch these plans, contradicting wider sustainable energy objectives.

> “The PM plans for a green revolution, but actions speak louder than words”

What is the future of responsible investment?

There are a lot of long-term targets which need to be met over the coming decades. An exciting development in the UK is that large companies and financial institutions will need to align themselves with the Task Force on Climate-related Financial Disclosures (TCFD). Hopefully companies, as well as investors, will be better able to understand the climate-based risks and opportunities.

The UK has passed a net-zero emissions law, meaning it has to bring greenhouse gas emissions down to zero by 2050. But this is a long way away and the steps that the government puts in place to ensure that this is successful are critical. The target for all coal-fired power plants to be closed by 2025 is one such tangible move that seems to be heading in the right direction. However, meeting these targets will not be easy.

For investors there are two paths, but this is not an either/or option. Investing in companies that are fully aligned to a 2050 vision is one route, but equally simply divesting from companies that have a greater challenge to align to a net-zero future could result in them falling behind and impeding the overall efforts. Therefore, we believe stewardship and engagement will be critical in ensuring companies are on the right track to achieving these goals. It is shareholders’ responsibility to hold companies accountable.

Glossary

As highlighted by the Charity Commission, 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 that have the best ESG (see below) record within their sector. 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 sometimes follows a period of engagement (see below) with a company that fails to produce 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 investments, rather than basing the decision only on financial factors.

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

Greenwashing
The mislabelling of investment offerings as more responsible, ethical or environmental than they in fact are.

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

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.

Hopefully, responsible investment offerings are becoming more sophisticated and proactive, and some of these data points will continue to move in the direction that charities would want them to. However, "greenwashing" concerns remain amongst some charities, and there has almost certainly been the relabelling of some offerings and products as the demand for responsible investment solutions has grown. It is important that investment managers now demonstrate how they ensure they are truly responsible investors. It is also important that charities know the questions to ask to hold their managers to account in this area.

INVESTMENT RETURNS

One question that all investors will inevitably ask their investment manager is about the level of return they are making on their investments.

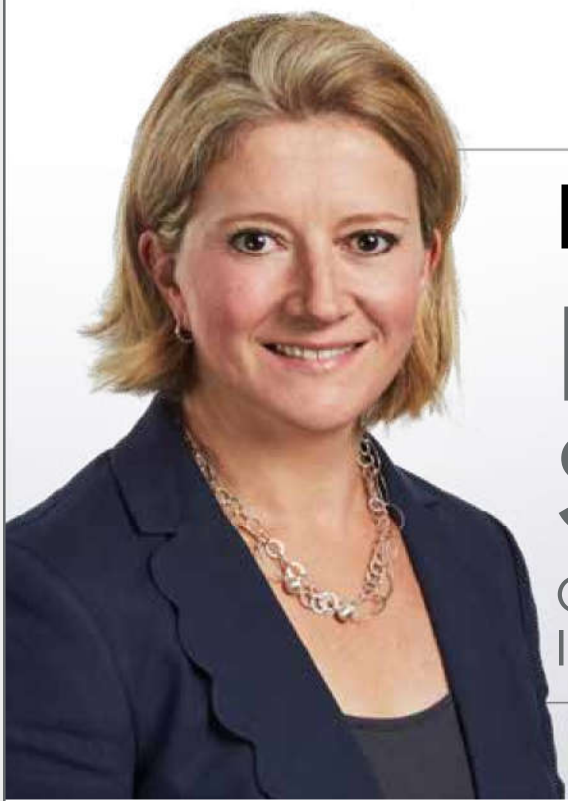
As already noted, the Charity Commission identified that there is still a perception that investing responsibly will reduce returns. This does seem to be diminishing though. The Intentional Investing survey found that 61% of charity investors now believe that these policies make no difference to returns, with 27% believing responsible investment practices increase returns.

> "ESG integration seems to perform better than negative screening"

Evidence is also starting to suggest that fears over investment returns are unfounded. In 2020, the NYU Stern Center for Sustainable Business released a report titled ESG and Financial Performance: Uncovering the Relationship by Aggregating 1,000 Plus Studies Published between 2015-2020. It found that 59% of the studies into the performance of ESG investments "showed similar or better performance relative to conventional investment approaches, while only 14% found negative results". The remaining 28% gave mixed results.

It also said that "ESG integration, broadly speaking as an investment strategy, seems to perform better than negative screening approaches", adding that this approach also "appears to provide downside protection, especially during a social or economic crisis".

Regardless of the investment return, there are many compelling arguments for responsible investment. Demand will continue to increase and the offerings will hopefully continue to mature and evolve to changing needs. The march of responsible investment is already well underway. ●



Interview with ELIZABETH SHELDON

Chief operating officer – CCLA Investment Management Ltd

CCLA's new benchmark highlights the need to assess employees' mental health

With social and work routines severely disrupted over the last year, the pandemic has highlighted the need for companies to engage meaningfully with their employees on issues around mental health and wellbeing. But for one investment management company, this revelation is nothing new.

> "The human and economic costs for mental health can be an obstacle to success"

"We believe that investment markets and the returns you expect to achieve will only be as healthy as the communities they support," says Elizabeth Sheldon, chief operating officer at CCLA. "Therefore it was important to us that we looked into the mental health practices of our investees. We believe very strongly that the human and economic costs for mental health can be an obstacle to success."

With this in mind, in February 2019 CCLA used the recommendations set out by a government-commissioned report, as well as input from an expert advisory committee co-chaired by Sheldon, to create a set of five, workable best practice measures. A select group of 11 companies was chosen to review the criteria and assess their own progress in these areas. The measures were: having a mental health at work plan; promoting mental health awareness among employees; integrating mental health safeguarding into job design and workplace conditions; training managers; and monitoring and reporting on employee mental health and wellbeing.

The survey found that while some of the businesses had gone above and beyond expected standards, others had made little or no progress.

MORAL AND ECONOMIC DRIVERS

For CCLA, the economic case for mental health to be pushed up the agenda when considering investments is clear. "There are obvious financial benefits to a big company looking after its workforce and it makes sound financial sense for an investor to consider mental health when they are looking at companies in which to invest," says Sheldon. "We have always thought that the economic cost of ignoring this is too high to dismiss."

This claim is backed up by recent research. According to an ISO study, mental ill-health was the highest cause of long-term absence from work in 2018, accounting for 57% of lost working days. Deloitte estimates that absenteeism, combined

What we do

CCLA is a specialist investment manager dedicated to serving charities, faith organisations and the public sector. Tackling the issues of our day head-on as responsible investors is the only way to deliver strong, sustainable returns to our clients. Our pioneering approach to responsible investment originates from our heritage as the investment advocate for not-for-profit organisations.

CCLA Investment Management Limited is authorised and regulated by the Financial Conduct Authority.

CCLA

GOOD INVESTMENT

FAST FACTS

- 60+ years of ESG investing*
- No. 1 manager of UK charities**
- £12bn+ in assets under management*
- First investor initiative to protect mental health at corporates*
- £7tn+ of assets supporting CCLA initiatives*
- Founder member of four global climate initiatives*
- A+ rating by PRI***

*CCLA: Internal as at 1 March 2021
**Charity Finance Fund Management Survey November 2020
***PRI Assessment Report 2020

with lost productivity and staff turnover, results in a total cost to employers of up to £45bn a year.

There is also a strong moral case, argues Sheldon. "Companies have a moral obligation to maintain the mental health of their workforce. As investors, we can help to drive the kind of positive change needed within a company."

The Covid-19 pandemic gave even more impetus to CCLA's programme. By April 2020, the investment manager had built a coalition of investors, with a total of £2.2tn in assets under management, and wrote on their behalf to the CEO of every FTSE 100 company, whose combined workforce numbers around 4.7 million. The letter urged them to take steps to protect the mental health of their employees during the pandemic and demonstrate what they were doing.

"By the end of 2020, we had around 74 responses," says Sheldon. "A lot of these companies were doing great things, but the efforts were disjointed and sometimes senior members of staff were less engaged than we felt they ought to be. This is where, as investors, we feel we can be a genuine catalyst for change."

MENTAL HEALTH BENCHMARK

CCLA has a history of affecting real-world change, being at the forefront of efforts to tackle modern slavery for example. By joining forces with Chronos Sustainability Ltd with backing from Mind CEO Paul Farmer and Lord Dennis Stevenson, CCLA has set about developing a Corporate Mental Health Benchmark – a global framework for assessing corporate mental health practices in a relevant, systematic and credible manner.

The first stage of this was a six-week consultation which ran during the early part of this year. "The findings from the consultation will be used to inform the assessment criteria," explains Sheldon. "We will test those with some key stakeholders and we are hoping to pilot the benchmark to 20-30 companies shortly."

> "As investors, we can be a catalyst for change"

The intention is to create a quantitative tool that can be used to help shape analysis and provide some more context when it comes to mental health, says Sheldon. "We see the CCLA Corporate Mental Health Benchmark as becoming a tool for investors to assess one particular aspect of ESG. It is about getting the data and encouraging companies to follow best practice, while giving them a framework to do so."

Launching in 2022, Sheldon hopes the benchmark will provide a "true picture for investors that realise the value of employee mental health as a vital aspect of a company's success".

The pursuit of growth for its own sake is simply not sustainable

Economic growth for growth's sake is an unsustainable model. Charities could use their investments to help shift this paradigm, says Dominic Burke

"GDP ONLY MEASURES ACTIVITY WHICH HAS A MONETARY VALUE, REGARDLESS OF WHETHER IT CONTRIBUTES TO OR DETRACTS FROM OUR SOCIAL HEALTH"

Dominic Burke
is investment director at Lankelly Chase

INCREASING NUMBERS of citizens, cities and countries are building alternatives to a model which has had its day. From Wales to Amsterdam and Costa Rica, people are recognising that our approach to economic growth is incompatible with a sustainable future. But what does this mean for responsible investors?

Members of the Charities Responsible Investment Network recently explored this question in a report titled Growth Narratives. Framed as an ongoing inquiry rather than a final set of conclusions, our report asserts that charitable investors can catalyse an evolution in sustainable investing.

THE GROWTH PARADIGM

According to economist Kate Raworth, this space exists between the social foundations essential for human flourishing and the thresholds of ecological sustainability, also known as planetary boundaries. It is where we can thrive by "meeting the needs of all people within the means of the living planet".

Rather than aim for this space, however, global governments have pursued gross domestic product (GDP) as an inherently positive and boundless priority. This fixation on aggregate economic growth is at odds with many of the social and environmental objectives which charities pursue.

GDP only measures activity which has a monetary value, regardless of whether it contributes to or detracts from our social and ecological health. And, crucially, GDP growth does not deliver the "progress" which we often assume it will.

Above a certain level of per-capita income, for instance, GDP growth no longer improves peoples' welfare or life satisfaction. More equal income distribution and access to quality public services are of greater importance. In fact, GDP growth has often contributed to inequality, as the already-richest capture the majority of gains.

> "GDP growth has often contributed to inequality"

The cumulative physical footprint of GDP growth also represents a "great acceleration" in humans' impact on nature's capacity to regenerate. The Stockholm Resilience Centre's planetary boundaries framework shows that the physical extraction, throughput and waste associated with economic activity is threatening the processes we depend upon to regulate vital Earth systems. We are already breaching key measures of biodiversity, land integrity and chemical flows. Contrary to the hope of "green growth", there is insufficient evidence that GDP can be decoupled from material impact on the scale required to stop this trajectory.

These challenges to the growth model are increasingly being validated by mainstream policymakers, including the World Economic Forum's Dashboard for a New Economy. In his recent, seminal review for HM Treasury titled The Economics of Biodiversity, Professor Sir Partha Dasgupta remarks that "no amount of technological progress can make economic growth as conventionally measured an indefinite possibility. Ours is inevitably a finite economy, as is the biosphere of which we are part."

It's important also to stress the extreme inequity of the current model in terms of who contributes, benefits and is burdened with the consequences. It is driven by the consumption patterns of the richest people in high-income nations, largely at the expense of those in the Global South. We will still need certain things to grow to make sure that everyone can thrive within the safe and just operating space. But in the words of Simon Kuznets, who devised the GDP measure, "goals for more growth should specify more growth of what and for what."

Of course, there are reasons why governments continue to prioritise aggregate GDP growth. Our economies have become dependent on constant growth in order to avoid unemployment and debt crises arising from recessions. Our monetary and financial systems in particular, governments suggest, are key drivers of this structural growth dependency.

UNSUSTAINABLE INVESTMENT PRACTICES

So, how does this relate to the investment practices of charities?

As with the economic goals of policymakers, the problem is that compound financial return expectations ignore the science of ecological limits.

Investment committees hope to grow their endowments by 4% or so each year. Their investment managers select companies on the basis of financial models which forecast profit growth in perpetuity and then incentivise management teams to deliver this, often at all costs.

WHAT ABOUT ESG?

We might hope that "sustainable investment" would, by definition, already recognise the unsustainability of this economic model and the financial system which sits within it. So far, however, environment, social, and governance (ESG) investors as a whole have not internalised or acted upon the flaws of the growth paradigm.

What distinguishes such investors is the attention they give to companies' social and environmental impacts. In many cases, their intention is only to assess the implications for financial returns. But, even where investors seek real-world improvements, they are generally incrementalist or measured relative to peers, rather than anchored in externally-defined planetary boundaries and foundational social needs.

Bill Baue, director of r3.0, observes: "So-called sustainable finance as currently defined lacks a specific link between portfolio-level impacts on ecological, social and economic resources, and the overall stocks of those resources at the macro-systems level. Accordingly, 'sustainable' finance as currently practiced has no mechanism for determining actual sustainability."

Efforts to align investment strategies with a 1.5°C carbon budget do reflect an understanding of planetary carrying capacities and will, if implemented, move us in the required direction. However, they address only one of the Stockholm Resilience Centre's nine planetary boundaries and often overlook the social foundations.

It is this partial perspective which leads us to invest in the electric vehicles needed to decarbonise the transportation system, without questioning whether it is truly sustainable to replace, let alone grow, the current vehicle fleet given the overall material footprint involved. ESG funds often favour high-growth technology companies for their potential to generate massive revenues relative to low physical and energy footprints. But they have little to say on how their business models, such as advertising, drive unsustainable consumption.

> "We shouldn't overlook our ability to shape policy"

A SUSTAINABLE APPROACH

While achieving a just and sustainable post-growth economy will require more than a shift in investment practices, we can identify a number of ways in which those practices will need to change.

Investors will need to proactively allocate capital towards activities which respect and sustain a safe operating space for humanity. These will support foundational social needs, civic infrastructure, material efficiency, environmental infrastructure and ecologies. Even with pockets of growth in these areas, investors will embrace lower returns to capital and longer time horizons.

Rather than focusing only on parts, for instance by "solving" for decarbonisation without accounting for the impact on ecosystems and communities, investors will think systemically about questions of scale and interdependence. To develop and maintain the social foundations, they will embrace more equitable forms of asset ownership.

CATALYSE CHANGE

How do we get to this place from our current, unsustainable model? Our report identifies interventions which charitable investors can make at multiple levels of the investment system to support the transition.

We should reframe our investment policies away from the maximisation of financial returns to reflect holistic objectives which contribute to a safe and just operating space for humanity. Investment portfolios should target activities which build and maintain this space. And they should avoid or transform business models which are at odds with the reality of our sustainability context, such as consumer advertising and planned obsolescence.

We must take a systemic view of the relationships between our investments and social and ecological thresholds, broadening existing decarbonisation approaches to encompass the other planetary boundaries. Investor action could help to persuade governments to set and act on targets aligned with these boundaries, similar to the UK's "net-zero emissions" law. While some data and methodologies may need to be developed, we can incentivise shifts by signalling our intent.

Indeed, we shouldn't overlook our ability to shape policy and market practice. As it stands, Charity Commission guidance says trustees "have a duty to maximise the financial returns generated from the way in which they invest their charity's assets." Environmental and social impacts are understood chiefly in terms of their impact on financial value, rather than the public benefit and missions of charities. However, The Charity Commission's current consultation on investment powers provides an opportunity to embed social and ecological thresholds at the heart of updated guidance.

Beyond our own sector, we could engage with the Financial Reporting Council – the companies regulator – and the Financial Conduct Authority's Listing Rules to explore the potential for sunset provisions in corporate purpose statements and articles of association. These would denaturalise the implicit expectation that companies should seek growth in perpetuity, and clarify their reasons for being with reference to specific social and ecological goals.

These are only a few of the actions outlined in our report. Our unsustainable approach to growth has been the elephant in the room – or investment committee – for too long, and we hope the report will create space for others to join our inquiry into new models of investing. ●

Disinvestment versus engagement

FRANZISKA JAHN-MADELL

Director, responsible investment – Ruffer

More charities are pondering disinvesting companies from their portfolios. What are the pros and cons?

What is disinvestment and what's in its favour?

Disinvestment is the act of selling the shares of a company in response to concerns over environmental, social, corporate governance (ESG) or ethical issues.

If we look at the fossil fuel sector for example, the predominant argument in favour of disinvestment is that fossil fuel companies have known about climate change for many decades and if shareholder pressure has failed to change their approach over this time, it is not likely to be successful now. Any charity with environmental concerns might no longer want to be associated with these companies.

The second argument is based on the beliefs or values of investors. This can be driven by environmental or societal concerns, or religious values. Both the Church of England and the Catholic Church have stated the importance of addressing the moral issues, primarily concerning intergenerational justice, raised by climate change.

The third argument is based on the economic risks of continuing to invest in fossil fuel companies. To achieve the goals of the Paris Agreement, society needs to reduce emissions of greenhouse gases and the consumption of fossil fuels. Consequently, there is a risk that fossil fuel assets will not be able to earn an economic return for their entire usable life and can become what is known as "stranded assets".

> "Engagement could now be a very powerful tool to effect real change"

What makes disinvestment less compelling?

While the arguments for disinvestment are all important and play a significant part in the debate about whether to continue to invest, for example, in fossil fuel companies, there are other factors that also need to be considered.

First, disinvestment is only possible once. While it can be used to make a statement, which is likely to gain the attention of fossil fuel companies, once the shares have been sold, it is often no longer possible to be involved in discussions with these companies.

Second, there is an argument that by selling the shares and depressing the share price, other investors without these concerns will be able to purchase shares at a lower price, allowing them to increase their profit while the business models of the companies remain unchanged.

These are the main arguments in favour of engagement.

What we do

At Ruffer, our focus is consistent capital preservation and growth. Most investment managers invest to a benchmark, meaning that their performance is closely anchored to the fortunes of the market. We create an 'all-weather' portfolio designed both to grow capital in the good times and, crucially, to preserve it in the bad, such as last year during the pandemic.

FAST FACTS*

- Over £21bn 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

*Figures as at 31 December 2021

What is engagement and can it make a difference?

Engagement is the process of continued dialogue with companies and other relevant parties, with the aim of influencing companies' behaviour in relation to ESG considerations.

Investment managers and asset owners, along with many environmental groups, have been engaging with companies about climate change for a number of years. Decarbonising the economy as a whole, including hard-to-abate sectors such as fossil fuel, building materials, aviation and shipping, will be key to transition to a low-carbon economy in line with governments' net-zero commitments.

There are valid concerns about the success of engagement so far. However, in the last few years there have been considerable shifts, and engagement could now be a very powerful tool to effect real change. As concerns about climate change have intensified, the desire to engage with companies on these issues has grown. This has led to the launch of a number of shareholder initiatives, including Climate Action 100+, which has three high-level goals on climate-related matters – to improve governance, reduce emissions and increase disclosure. Ruffer is a founding signatory of this five-year global initiative, and through it, investors commit to engaging with 161 companies that have significant greenhouse gas emissions in industries from metals and mining to consumer products.

> “Engagement and disinvestment can be combined”

Does Ruffer recommend disinvestment or engagement to its clients?

There is no reason why engagement and disinvestment can't be combined. Investment managers often commit to engage with a company for a set number of years, but if companies haven't achieved certain targets by the end of this period, they then consider disinvesting. This approach can be particularly powerful if the timeline is publicly shared with the companies.

At Ruffer, disinvestment is one of the escalation mechanisms we use as part of our engagement process. Others we deploy before disinvestment are, for example, filing a shareholder resolution, voting against executive or non-executive directors, or making a statement at an AGM.

A growing number of companies are now making significant commitments to reduce their greenhouse gas emissions, and to align their business models with the goals of the Paris Agreement. This partly reflects public pressure – and related reputational risks for businesses – but also, importantly, reflects the influence of shareholders through collaborative initiatives such as Climate Action 100+.

The Race to Zero

MERYAM OMI

Head of sustainability and responsible investment strategy

NANCY KILPATRICK

Head of charities – Legal & General Investment Management

Ambitious decarbonisation goals by 2050 are driving LGIM's ESG strategies

Tackling global climate change is a pressing concern and all parties will have to commit to decarbonisation targets, whether they be governments, corporations or investors. "It is the power of the private sector that really pushes governments to come up with ambitious goals," says head of sustainability and responsible investment strategy at Legal & General Investment Management (LGIM), Meryam Omi. "At LGIM, we aim to mobilise all non-state actors to commit to net-zero targets through the Race to Zero campaign. The idea is that everybody aims for net-zero greenhouse gas emissions by 2050."

> "We aim to mobilise all non-state actors to commit to net-zero targets"

Asset holders, including charities, have a vital role to play in achieving this target. "It's not about only investing in green companies; it's about investing in line with the trajectory of decarbonisation," continues Omi. "We have been pushing companies for a long time on environment issues and they are realising that it makes strategic sense to be embrace this agenda. This is not a CSR exercise or something they do on the side. We have aligned all our engagement to net-zero, so asset owners, who are committed to tackling environmental issues, can be reassured that LGIM is engaging with companies on their behalf to achieve global targets."

MEASURING SUCCESS

One of the key elements to the success of this campaign is figuring out what decarbonisation looks like for different sectors and how it can be achieved across different asset classes. LGIM combines both qualitative and quantitative metrics to measure how a company is performing in relation to the net-zero framework, says Omi.

"Through our quantitative measures, around 1,000 companies are rated based on market standard disclosures, which operate on a traffic light system indicating what key areas they need to address and when they are lagging behind their peers," she says. "We publish these on our website, which is pretty rare from a mainstream provider's perspective."

This "radical transparency" allows companies and investors to see the thinking behind investment and stakeholder voting decisions, and helps to push environmental, social and governance (ESG) disclosure up the agenda across

What we do

We are here to help organisations make the most efficient use of their investments. In a time where 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.

Legal & General
INVESTMENT MANAGEMENT

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

the "entire investment ecosystem", says Omi.

The qualitative element employs in-depth, sector-based research on 60 second-tier companies, which may be slower to embrace decarbonisation, and focuses on what LGIM thinks net-zero transition means for them. "There are unique dynamics in each sector, so as investors, we can't just use one blunt tool to analyse performance," explains Omi. "We need to be sensitive to those dynamics and push those companies over the line to commit to a net-zero strategy. This in turn influences the whole market."

KEEPING ON TRACK

For head of charities at LGIM, Nancy Kilpatrick, this transparency is key. "It's about encouraging companies to do better," she says. "We use these metrics as part of our overall ESG investment strategy, whether it be around climate change or other ESG scores, and this drives how much capital is invested in these companies. So tying capital allocation together with transparent assessment and engagement gives rise to a feedback loop that we think is really important and quite unique."

As well as keeping corporations on track, this level of transparency is beneficial from an investor perspective, says Kilpatrick. "There are literally hundreds of thousands of different ESG funds and strategies out there, so it is critical that we ensure that clients understand what the strategy is trying to do and that it actually meets their needs, not only in terms of investment, but also in regards to their ESG goals. Ultimately, this comes down to the partnership you have with your investment manager."

> "It's about encouraging companies to do better"

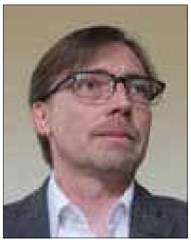
As demand for ESG funds continues to grow, this relationship is crucial, says Kilpatrick. "Everyone wants to be investing in the right way, and to adopt ESG strategies, but what does that really mean and what does it look like? It is up to the investment management industry to really try and glean from our clients what is important to them and translate that into implementable strategies that our clients can adopt to help them achieve their goals. We try to make this as mainstream as possible, because climate change affects all of us. It is both a global and a financial issue."

Omi adds: "I would like to see charities embracing the Race to Zero campaign, along with every other asset owner. It's a framework that can really work for charity investors and it makes sense from a financial perspective. Moreover, it is a race that we have to win together."

Poor ESG investment standards are risking credibility

Last year, the ESG Investing Olympics took place. Colin Baines *reflects on they revealed about the offerings available to charities*

"WE FOUND A WIDE VARIANCE IN THE QUALITY OF THESE FUNDS AND THAT MARKETING CLAIMS WERE NOT ALWAYS ALIGNED WITH PRACTICE"



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

THREE CHARITIES, Friends Provident Foundation, Joffe Trust and Blagrave Trust, came together in 2020 to launch the "ESG Investing Olympics", a first-of-its-kind, open, competitive tender for an investment mandate of £33.5m. The key instruction was simply to "impress us" on environmental, social and governance (ESG) integration and impact.

The scale of response blew us away, with proposals from 59 investment managers with combined assets under management of £15tn, and a great deal of interest from asset owners and press.

To shortlist five managers from the 59, we assessed the proposals against various indicators of ESG integration, including in-house expertise, stock selection, shareholder voting record, shareholder engagement and its escalation, exclusion policy and impact reporting.

The shortlist of five were invited to present at the Royal Institution to an audience of asset owners who share our desire to create impact through their investments, including charities, churches and pension schemes.

Cazenove Capital was declared the winner and the Cazenove Sustainable Growth Fund was launched in early 2021.

To help fulfil our objectives, we have taken our analysis of the 59 proposals and produced the ESG Investing Olympics – State of the Sector 2020 report. Our analysis of the proposals brings us to conclude that there are areas in need of urgent attention.

Growing demand is leading to exponential growth in funds that are labelled as impact, sustainable, responsible, green or ESG. However, we found a wide variance in the quality of these funds and that marketing claims were not always aligned with practice.

> "Some proposals did not cover social issues at all"

We believe the priority for asset managers should be to address the most basic and serious gaps we found which, if unaddressed, risk the credibility of the ESG market. As such, we ask that asset owners, like endowed charities, utilise the report's recommendations as minimum ESG standards in their asset manager tenders and reviews.

THE STATE OF THE SECTOR

Some key findings from our report:

In-house expertise

Most proposals claimed to have in-house ESG expertise but on examination few did really, especially relevant environmental and social experience, whether in finance, business, NGOs, academia or government.

The weakest proposals were totally reliant on third-party ESG indices and from asset managers with no in-house ESG expertise. This raised some fundamental questions around credibility and capability, and when we looked at these funds' holdings, we were not reassured about their ESG integration.

Stock selection

The weakest proposals came from global equity funds that solely relied upon a third-party screen or solely excluded fossil fuels. We suspect most of these were rebadged standard funds.

A key finding from looking at stock selection is that the "S of ESG" is the poor relation of E and G issues. We found a lot of funds investing in sectors like technology, media, consumer, utilities, manufacturing and retail, many of which are high risk from a social perspective. Yet, manager's integration of social criteria and engagement on social issues are observably far less well developed. Some proposals did not cover social issues at all.

High risk companies kept appearing in the top holdings of global equity funds, such as Amazon, an aggressive tax avoider singled out by the principles of responsible investment (PRI) for failing to substantively respond to engagement on the subject, and a regular subject of news coverage regarding poor working conditions.

The lack of consistent, comparable, data across a very wide range of issues was often cited for this poor integration. Social issues are often more difficult to integrate than environmental issues due to a lack of data, but we still found a wide range of standards.

Voting

We found a very wide range of voting behaviour. The worst practice we found was non-disclosure of voting record and outsourcing of voting with no accompanying ESG policy or instructions. Best practice included quarterly disclosure of voting decisions, including statements on votes against management, votes for and against independent ESG resolutions, and abstentions.

The best proposals we received could evidence high levels of support for ESG resolutions and votes against management as part of engagement escalation. The rationale for votes was also communicated to investee companies.

Very few asset managers had a presumption to vote in favour of ESG resolutions, but most stated they were willing to adhere to our investment policy that necessitates this.

Engagement

Another area where we believe ESG market standards are not where they should be is shareholder engagement and its escalation.

Most examples of engagement provided were limited to letters or meetings, and too many relied on being signatories to collective engagement initiatives, primarily on climate change, as proof of active engagement.

The best proposals could evidence active and meaningful engagement programmes, from letters and meetings through to more forceful stewardship, such as voting against board reelections and co-filing shareholder resolutions. Their engagement also went further than requesting better disclosure or distant targets to actual short and medium-term behaviour change.

Many managers lacked formal engagement policies and processes, and a large majority did not have an engagement escalation policy. Promisingly, some managers recognised that their engagement frameworks, particularly around escalation, were lacking, and offered to work with us on the development of those frameworks if they were to win the tender. Hopefully that recognition will be acted upon regardless of winning the tender.

Once again, proposals were poor on the "S of ESG". Few included evidence of any engagement on the priority themes identified in our investment policy, for example, fair pay, decent work, management diversity, and tax avoidance.

Exclusions

Virtually all the proposals excluded fossil fuels, as per our investment policy. This is perhaps the most marked improvement we identified in the ESG market.

It was not long ago that the number of mainstream asset managers with exclusion policies could be counted on one hand, and raising the spectre of divestment at a conference could empty a room of asset managers. Now there are dozens of investment products and strategies that offer just that. This demonstrates that where mission-led asset owners prioritise, the market often follows.

> "It would be quite incredulous to not divest coal and tar sands"

Whilst our policy is clear on fossil-fuel exclusion, the whole divest versus engagement debate is often disingenuous. The number of managers either divested or engaging on climate change meaningfully (science-led and escalating as necessary) are in a minority and it is that that needs to change. It would be quite incredulous to not divest from coal and tar sands immediately though.

But again, exclusion was another area lacking on the "S of ESG". Those that did address it did so with a general commitment to the UN Global Compact.

RECOMMENDATIONS

Based on these findings we produced the following recommended minimum standards.

- **A presumption to vote in favour of ESG resolutions,** taking a "comply or explain" approach with disclosure of rationale. Asset managers cannot make claims to ESG integration and engagement and then by default vote against their stated ESG objectives. They need to overcome any reluctance to oppose management when necessary or any reluctance to support independent resolutions.
- **Active ESG engagement that goes further than disclosure or distant targets to effect real change in the near term.** For example, on climate change, it should include net zero transition plans with science-aligned short- and medium-term targets. Memberships of third-party initiatives and signing occasional group letters are insufficient evidence of active engagement.
- **Engagement-escalation policy.** Asset managers should produce clear policy around the escalation of engagement and how this might happen, for example voting against board re-elections, tabling shareholder resolutions and ultimately divestment, plus transparent disclosure on the implementation of that policy. Claims to ESG engagement are unconvincing without such a policy and a willingness to oppose management when necessary.
- **Integration of the "S of ESG"** into stock selection and shareholder engagement. In general, social issues are more difficult to integrate than environmental issues due to a lack of consistent, comparable, comprehensive data across a very wide range of issues. For many asset managers this is exacerbated by a reliance on third-party data-driven indices. Asset managers need to develop greater in-house ESG expertise to be able to take a materiality approach and make judgments on the best available evidence, and must overcome an aversion to working with social and environmental NGOs.
- **Regular disclosure of all holdings, voting record and engagement activity,** including statements on votes against management and votes for and against (and abstentions from) independent ESG resolutions, and disclosure of ESG engagement goals, methods of engagement and escalation, assessments of progress and outcomes against defined objectives. Examination of holdings and voting record is perhaps the easiest way for asset owners to sense-check whether ESG claims match their practice. This level of disclosure should be considered a minimum standard. ●

New era of opportunity

IAN CHESHAM

Director, Charities Team – Barclays Private Bank

Covid has changed the investment landscape creating even greater opportunities in ESG

Last year was like no other and as 2021 continues in a similar vein, there is time to reflect on what this means for sustainable investment moving forward.

"We have always been proactive when it comes to environment, social and governance (ESG) factors," says Ian Chesham, director of the charities team at Barclays Private Bank. "We have continually encouraged charities to consider how they are investing responsibly, to set out a robust investment policy, and to openly declare what they are doing. But 2020 was really the year when non-financial elements came to the fore."

" Sustainable strategies outperform traditional peers "

The initial danger as the pandemic struck was that there would be a knee-jerk reaction from finance directors at charities scrambling to make up for lost income through higher returns on investments and putting ESG considerations on the back-burner. Chesham says this was not the case. "What we saw, understandably, was a focus on cash-flow, the availability of liquid funds and lending capabilities. At Barclays we have the ability to lend against investment portfolios, enabling our clients to remain invested in their sustainable portfolio, while at the same time providing them with greater liquidity. Consequently, we didn't see a slowdown in the interest and uptake of sustainable strategies for fear of reduced returns."

In fact, Chesham says that last year finally debunked the myth of lower returns on responsible investments. "We saw sustainable strategies, on average, outperform their traditional peers. If you look at the Barclays sustainable strategy, for example, we delivered over 20% returns last year, which is comfortably and significantly ahead of traditional peers."

LONG-TERM IMPACT

Chesham says that the crisis shone a spotlight on companies' resilience as investment prospects. "The ones that have good health and safety protocols, that have treated their employees well and acted quickly, are the ones that have succeeded through this crisis."

This is likely to continue to be the case as the effects of the pandemic are long-term, says Chesham. This presents new and different opportunities. "I think we've made a fundamental shift in the way we work and that will impact how we measure success and the ESG credentials of companies," says the veteran wealth manager of 17 years. "Those that haven't been able to rapidly

What we do

Barclays Private Bank offers specialist investment advice and portfolio management to charities and not-for-profits. Our nationwide team of experienced and dedicated sector specialists work with you to understand your requirements and create bespoke solutions that help meet your financial objectives in line with your organisations' values. Our services include: discretionary portfolio management, including ethical, sustainable and impact investment strategies, with direct access to your portfolio manager; treasury and short-term cash management; liability-matching investment strategies; credit facilities, including Securities Backed Lending; and exclusive access to private asset opportunities (private equity, private debt and infrastructure).

BARCLAYS

FAST FACTS*

- Over 60 years' experience working with charities across the UK
- Barclays Private Bank has in excess of £2bn charity assets under management
- Over 1/5 of the largest 5,000 charities in the UK bank with Barclays

*Figures correct as at 31 December 2020

adapt to circumstances such as home-working and employee wellbeing are going to struggle longer term. And I can't see things going back to the way they were. I think we'll carry on pushing forward. Those organisations that have taken advantage of innovations in digitisation, for example, have thrived."

Chesham points out that a focus on responsible investment was becoming more prominent even before the pandemic. "ESG conversations have been moving up the agenda for a number of years and 2020 saw the largest-ever issuance of social bonds. In 2021, we will see the first-ever UK green gilt issuance. Financial institutions such as Barclays and others have now got product suites with green and sustainable solutions firmly embedded. So the new possibilities are fantastic."

This potential can help propel vital change to the way companies operate. "If you think about the trillions of dollars that you need to change the world to be more sustainable, that can only ever come from governments and financial institutions lending money. This presents a great opportunity long-term. It's about driving change and financially incentivising change, not only because it's the right thing to do, but also because it offers commercial value."

THE ROLE OF CHARITIES

Charities' role in this transformation is evolving along with the investment landscape. "Charities are always going to have an affinity with certain areas of ESG or particular UN Sustainable Development Goals," says Chesham. "But the evolving landscape within the financial system means that you can implement those more easily and there are more options. You can be far more targeted now than you used to be. So there is a greater opportunity for charity trustees to really hone in on what they want to achieve with their investments."

> "It's about driving change and financially incentivising change"

When it comes to mainstream liquid investments, Chesham says charities have a lot more power and flexibility than even a few years ago. "There's plenty of choice out there and I would say returns aren't diminished. Typically, a charity will hold a multi-asset class portfolio that does everything for them. What is exciting is that you can have that portfolio with the majority of it achieving those returns but you can be particularly targeted in certain areas, to widen your reach and your impact.

"By investing sustainably and looking for positive impact you can see the huge social benefit or lasting change that you have implemented through your investments."

A year of progress and a horizon of opportunity

One year on from ACF's Stronger Foundations investment report, Gail Cunningham reflects investing responsibly and what the future might hold

"MORE FOUNDATIONS THAN EVER ARE CONSIDERING HOW TO DEPLOY ALL THEIR RESOURCES IN PURSUIT OF THEIR CHARITABLE MISSION"

Gail Cunningham *is head of investment learning at the Association of Charitable Foundations*

NEARLY A year has passed since the Association of Charitable Foundations (ACF) launched the Stronger Foundations: Investment report. It is the fifth report to emerge from ACF's Stronger Foundations initiative (https://www.acf.org.uk/policy-practice/stronger-foundations/), which is a flagship project to help grantmaking charitable foundations identify and pursue ambitious practice.

This milestone offers an opportunity to reflect on our progress and consider what is on the horizon in relation to foundation investments. As Carol Mack, CEO of ACF, set out in the foreword to the report: "For many foundations, an endowment is their 'super-power'. Financial independence and a long-time horizon provide unique opportunities to work towards achieving…long-term impact, to effect change, and to withstand financial turbulence. A well-managed investment portfolio is the engine that powers a foundation's activity... but maintaining the value of a foundation's capital is not a charitable purpose nor an end in itself."

The report set out seven pillars which characterise excellent practice, stating that a stronger foundation:

1. Understands that responsibility for its investments sits with each and every member of the trustee board.
2. Prioritises its mission when setting its investment objectives.
3. Engages with and holds to account those managing its investments.
4. Pursues transparency and responds to scrutiny.
5. Actively seeks a variety of research and views to inform its approach to investment.
6. Reviews its own time horizon.
7. Seeks to positively influence the behaviour of others in relation to investments.

> "We wanted to move away from exclusions"

Many ACF members have used the seven pillars as a framework for analysing their foundation's investment approach. For example, as Felicity Mallam, director of Wates Family Charities, commented: "Our socially responsible investment policy was the culmination of a year's discussions at board level. The Stronger Foundations report provided a reference and checklist as we developed our policy. We used the pillars to reflect on our current practice and what we wanted to aspire to.

"We wanted to move away from exclusions to making more conscious investment choices. Alongside a financial return, we seek to make positive environmental and social returns, and look for proactive engagement with the companies being invested in. We now have environmental, social and governance (ESG) reporting on the agenda at each investment committee meeting.

"As there is no one standard ESG reporting framework, there is variation in how each fund manager reports. One simple reporting tool we implemented was asking our investment advisers to list the top and bottom five contributors in certain funds in terms of performance, alongside their ESG rating. We were then able to make clear and informed decisions to withdraw from or reconsider certain investments.

"We are moving to a place where our investments are more closely aligned to our mission. We hope to be able to reflect more comprehensively on the impact of our total assets and to share this publicly in the same way as we would report on the impact of our grantmaking."

RESOURCES AND SHARING PRACTICE

More foundations than ever are considering how to deploy all their resources in pursuit of their charitable mission, and guidance to help them is developing at pace. At the end of 2020, ACF launched our Stronger Foundations self-assessment tool, which allows foundations to select a thematic area, such as investment, to assess themselves on. Results from the tool can be helpful for board-level discussions, staff meetings and strategic reviews. Foundations can also use them to track progress against internal targets.

Foundations using the tool have ranged from those just starting to consider aligning their investments to their mission to those at a fairly advanced stage or with strong practice fully embedded. Foundations have reported that it prompted them to take the following actions, among others:

- Offering training to all trustees to ensure a level of investment literacy and empower all trustees to feel confident participating in discussions about the foundation's investments.
- Reviewing the approach of other foundations and discussing this with investment managers.
- Ensuring ESG reporting is embedded within investment reporting, and that trustees consider a broader range of voices regarding investment practice.

Other resources available to foundations considering their investment practice include:

- Share Action and the Charities Responsible Investment Network
- EIRIS Foundation
- Church Investors Group
- ESG Investing Olympics State of the Sector report

> "2021 is shaping up to be a year of exciting progress"

LOOKING FORWARD

While most foundations are still focusing on their responses to Covid, they are also thinking hard about how to make the most of all their assets for public benefit. 2021 is already shaping up to be a year of exciting progress and the need to meet key challenges in relation to foundation investment practice. Three areas of particular importance are:

1. Regulation

The Charity Commission for England & Wales has launched a public consultation on sections of the investment guidance for trustees that cover responsible investment. The consultation will run until mid-May. This follows a listening exercise undertaken during 2020 which found that "the way responsible investment is outlined in current guidance is not giving some trustees sufficient confidence that they can consider, or that the Commission supports, this [responsible] approach to investment."

ACF responded to the listening exercise and members are now looking forward to engaging with the Commission on the consultation. Many see the revised guidance as an opportunity to give impetus to board discussions and to take concrete steps towards stronger investment practice.

In 2018, the Scottish Charity Regulator published updated p56

Building back after Covid

TANIA MCLUCKIE

Specialist charity manager – Sarasin & Partners

It's a brave new world, but the focus on responsible long-term behaviour remains the same

Can shareholders influence companies post-Covid?

Covid-19 has exacerbated inequalities both within and between countries. As shareholders, we have a responsibility to press for responsible long-term behaviour that is aligned with societal interests. We have a voice, backed up by voting powers, that gives us a say in who leads these companies. Having signed the ICCR Covid investor statement, we are engaging investee companies in five core areas:

1. Ensuring fair treatment of staff – While companies need to ensure their financial strength, they should do so responsibly and fairly.
2. Companies need to pay their fair share of tax – Taxation is vital to ensure governments can invest in critical infrastructure and public services.
3. Executive pay reductions – Shareholders need to make it clear to boards that the pain must be shared.
4. Dividends need to be sustainable – Dividends, like bonuses, are only appropriate where they are underpinned by a sustainable business.
5. Building a more equitable society – By investing in their people, being responsible taxpayers, avoiding egregious executive pay-outs and playing fair in the marketplace, executives will build more resilient businesses. Only then can shareholders know their capital is being used to deliver a sustainable business.

> "Covid-19 has exacerbated inequalities"

What has changed since the Paris Climate Accord?

Global emissions have risen four out of the last five years and we still need deep decarbonisation to align with the Paris Agreement. However, the last 12 months have given us cause for cautious optimism as global commitments to net zero have accelerated. President Biden's win in the US has placed climate mitigation at the centre of its administration's policy; the EU has ratcheted up its 2030 emission reduction targets; and China has announced a net-zero 2060 target, which was followed by Japan and South Korea announcing 2050 targets.

The tone is changing. While it was previously seen as detrimental to shareholders to embark on more radical emissions reduction strategies, we have seen a real appreciation around the economic rationale for these deep decarbonisation pathways and how important it is to all stakeholders to make the transition. The rate of adoption of science-based climate commitments among corporates doubled in 2020 versus 2015-19.

We take a holistic view as to the threats and opportunities of climate change; it is not just about divesting. Stakeholders can play a powerful role in changing the capital allocation frameworks of companies through the process of engagement. We have seen progress at BP, Shell and Repsol, which have started to shift capital allocation away from fossil fuel extraction – a move catalysed by the investor community.

What we do

Sarasin & Partners LLP is a London-based asset manager that manages £18bn* on behalf of charities, institutions, intermediaries, pension funds and private clients, from the UK and around the world.

Our goal is to grow and protect our clients' capital in a way that secures tomorrow. We take a global, long-term, thematic approach to investing – with responsible investment at its core. We identify powerful trends that will shape the investment landscape for years to come, and embed stewardship into our investment process.

SARASIN & PARTNERS

FAST FACTS*

- Sarasin manages £7.8bn for 450 charities and not-for-profit clients
- Charities represent nearly 50% of total business
- The Climate Active Endowments Strategy has been adopted by c£900m of charity assets, over £400m reside in the Sarasin Climate Active Endowment CAIF

*All figures as at 31 March 2021

How does the net-zero target impact investing?

In a decarbonising world, a net-zero business model is not a nice-to-have – it's essential for remaining viable. Carbon taxes, investor scrutiny, regulation and more conscious consumption are just a few examples of the increasing pressures businesses face in a net-zero world.

To achieve net-zero outcomes, in excess of $2.5tn still has to be spent annually and it is our view that capital markets in some sectors are not adequately pricing the scale and scope of some of these changes. This presents a huge opportunity.

We have a thematic approach to investing that helps us to identify opportunity sets that should benefit from long-term structural factors. Climate change is one of our five core themes and was a top performing theme within portfolios last year. We split this into two elements. The first is mitigation, which considers how we decarbonise, and presents investment opportunities in low-carbon transport and power, and resource efficiency. The second element is adaptation. The pathway to net-zero is multi-faceted and straddles a whole host of industries. One needs to consider the decarbonisation of agriculture, industrial processes, buildings and transport and how urban environments will have to adapt to climate change. In these relatively ignored vectors of decarbonisation, there are attractive investment opportunities.

> "A net-zero business model is not nice-to-have – it's essential"

What are the main areas of focus for 2021?

Our approach to engagement seeks to be supportive of positive action, but challenging to inaction. Over the course of 2021, we intend to prioritise:

1. Climate change – We will continue to press investee companies to make a public commitment to Paris alignment and set out a clear and compelling strategy with medium-term milestones.
2. Accounting and audit to underpin long-term stewardship – We expect directors and auditors to explicitly review and adjust accounting assumptions to reflect the transition to a 2050 net-zero pathway.
3. Responsible actions with respect to the pandemic – We will continue to press companies to take tangible steps to protect customers and staff, and ensure fair treatment within their supply chains. Where they do not we will vote against directors and/or remuneration.
4. Diversity throughout the workforce – Diverse perspectives help to avoid groupthink and bias, which will in turn foster a challenging company culture that helps drive long-term value.
5. Responsible technology – 2020 saw Big Tech under fire over perceived anti-competitive behaviour, tax, content management and privacy. Investors have been relatively silent on these trends; this needs to change.

Interview with KETAN PATEL

Equities fund manager – EdenTree Investment Management Ltd

The time has come for charities to drive social impact and emphasise the 'S' of ESG investing

The rise of environmental, social and governance (ESG) investing has been irresistible over recent years. However, more often than not the emphasis has been on the "E" and "G" rather than the "S". This, says equities fund manager at EdenTree, Ketan Patel, is an oversight that he has always been working to rectify.

"The pandemic has highlighted massive levels of inequality and social injustice"

"The social element of ESG is coming to the forefront now because of the pandemic, but the truth is that the 'S' has been prominent since the early days of ethical funds in the 1920s. It has always been part of the core DNA of what we do," says Patel. "However, the pandemic has highlighted massive levels of inequality and social injustice across society, whether they are based on gender, race or access to capital. There is little doubt the 'S' will continue to become more prevalent going forward as all aspects of our life, from how we work to how we socialise, have been impacted."

Patel suggests that one of the reasons the social aspect has played a lesser role in ESG investment strategies up until now is that it is harder to measure.

"There's still a lack of expertise in this area and the social aspect is often tacked on last minute when looking at long-term governance," he says. "The problem is around how you measure social impact and attach a monetary value to that impact. Environmental initiatives are easy to measure and easy to monetise. If we put solar panels on our homes, for example, there's a measurable return on that investment and there's a payback period. Social impact is less straightforward. It is about telling the stories of how people's lives have been changed."

Convincing clients, however, has been helped by the fact that myths around social investments having lower returns have been debunked, says Patel. "Twenty years ago it was thought that you had to give up financial returns for your values, but in terms of capital preservation, income and total return, ethical funds perform extraordinarily well. It's not binary anymore. It makes a much stronger case when you go to new or existing clients and show them how their money is making a real difference and where you can see social return, not just financial return."

In light of recent circumstances, Patel thinks that charities now have an opportunity to

What we do

EdenTree are pioneers in responsible and sustainable investing, having launched one of the first ethical equity funds in the UK in March 1988.

We believe that the companies still making a return tomorrow will be the ones acting responsibly today. That's why our approach to responsible and sustainable investing fully integrates environmental, social and corporate governance factors across every part of our investment process.

EdenTree Investment Management Limited (EdenTree) Reg. No. 2519319. EdenTree is authorised and regulated by the Financial Conduct Authority and is a member of the Investment Association.

edentree
investment management

FAST FACTS*

- 30-year track record
- £3bn of assets under management

*Figures as at 1 March 2021

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embrace social impact in how they invest even more. "This is a watershed moment where charities can come to the fore and state that social justice is now going to be a core part of how they present themselves. And their fund manager has to be aligned to that."

ALIGNING VALUES AND INVESTMENTS

Owned by a charitable trust, EdenTree has a deep understanding of this need to align investments with the values and missions of the organisations it supports. The key to maintaining this is due diligence and rigorous screening, says Patel.

"We have always looked at all three pillars of ESG. Capital has a role to play in holding management to account when it comes to all aspects of its operations including how it treats its employees and labour relations. We don't just look at the company but at the whole supply chain," he says.

Patel cites the example of Boohoo (never owned in EdenTree funds), which had an A+ ranking from some ESG rating agencies but then faced modern slavery investigations due to poor employee working conditions. Patel says that EdenTree has robust checks and balances that are designed to mitigate the chance of unintentionally investing in companies that operate bad practice and help avoid the associated reputational damage.

"We have an in-house team that constantly engages with the companies we invest in to avoid this type of risk for charities. It carries out independent research and publishes results for complete transparency. You have to remain vigilant because some companies start off well but then allow poor practices to seep in."

> " People may stop giving if they think a charity is not doing the right thing with its finances "

Patel says that although some trustees may still argue that their fiduciary duty is to make the most money, over recent years charities are seeing that there is a risk in just chasing high returns. "Charities have to be cognisant that their reputation matters more than it did even a few years ago. They can't just put their money in a tracker fund that makes lots of money but which invests unethically."

He says this is partly driven by contemporary thinking in wider society. "This generation is probably the most aware of the damage that has been brought on the planet, not just environmentally, but also culturally and socially. People may stop giving if they think a charity is not doing the right thing with its finances or having a positive social impact."

guidance relating to charity investments in Scotland - https://www.oscr.org.uk/guidance-and-forms/charity-investments-guidance-and-good-practice/. In particular, the guidance addressed the "myth" that "charity trustees in Scotland have 'a duty to maximise financial returns'. An investment doesn't have to make money at any cost." Foundations across England and Wales will be interested to see whether the Charity Commission follows a similar path.

2. Pursuing transparency and responding to scrutiny

In the year since publication of the report, approaches to diversity, equity and inclusion, economic inequality, and the need to pursue transparency and respond to scrutiny have all been to the fore for charities, including foundations. ACF members completing the Stronger Foundations tool noted the pursuit of transparency in relation to investment practice was the pillar most in need of work, with no respondents feeling their practice on transparency was at an advanced stage or fully embedded.

The work needed ranges from practical steps such as engaging with investment managers regarding the contents of the foundation's investment portfolio, understanding different ESG reporting frameworks, and harnessing technology to marshal and report on investments in an achievable way, to broader thinking about the role of foundation investment transparency as part of wider conversations with regard to control of capital, empowering stakeholders and ensuring equitable and inclusive practice.

As Dominic Burke, investment director of Lankelly Chase commented to ACF: "There can be practical challenges to transparency, including the layers of intermediation. Foundations often employ investment consultants who help select fund managers, who may then select other funds to invest in, before we arrive at the level of specific companies or assets. Lankelly Chase hope to make inroads by sharing publicly the 'statements of intent' we have agreed with our fund managers.

"As we embed racial justice at the centre of our work, acknowledging how the foundation's financial resources have been accumulated through extractive economic practices has pushed us to redouble our commitments. We have developed a racial justice accountability plan that specifically addresses our relationship with financial capital.

> "COP26 will maintain the focus on the climate crisis"

"We've become much more open about our approach to investments: where we are now (including publishing portfolio holdings quarterly), where we are headed, and the actions we are taking in service of our mission. This has supported greater mutual accountability with grant-holders – not least those with ethical fundraising policies."

3. The Climate Crisis

Over 50 foundations have signed up to the Funder Commitment on Climate Change (https://fundercommitmentclimatechange.org/) and which is hosted by ACF which includes a commitment to "steward investments for a post-carbon future, recognising climate change as a high-level risk to investments" and therefore to a foundation's ability to deliver its mission. Signatories commit to "proactively address the risks and opportunities of a transition to a post-carbon economy in their investment strategy and its implementation".

During the year, many signatories discussed climate and investment at a board level, in their investment committee, or with investment managers, in some cases for the first time. Some signatories rewrote their investment policy to reflect their climate commitment or agreed new investment strategies with stronger climate commitments, and some moved to new investment managers who they felt were better able to deliver on these commitments.

Key developments include foundations:

- Working towards a net-zero carbon target on their investment portfolio, with key milestones over the coming decade and consideration of the implications for investment strategy.
- Divesting from companies involved in the extraction, production and distribution of fossil fuels, deforestation, or intensive farming methods that degrade the environment.
- Identifying investment opportunities aligned with a post-carbon future, for example companies working in the areas of resource efficiency, pollution control, solar power, electric vehicles and clean water solutions.
- Considering which investment benchmarks are appropriate comparators for a post-carbon portfolio, and how net carbon equivalent emissions are being measured.
- Using the foundation's influence as a shareholder to push for a transition to net-zero carbon, both at a company level and with regard to institutions providing financing for carbon intensive activities.

COP26, the 26th UN Climate Change Conference of the Parties, will take place in November and will maintain the focus on the climate crisis throughout 2021. The summit will seek to accelerate action towards the goals of the Paris Agreement and the UN Framework Convention on Climate Change. As governments and other actors accelerate, all foundations will need to consider how their investments contribute to both the climate crisis, sustainable solutions and the creation of a post-carbon future.

A HORIZON OF OPPORTUNITY

Many foundations have continued to make progress despite the challenging context of the last year. The pandemic has thrown into sharp relief the scale of the need in our communities, and how vital it is that foundations deploy all their resources for public good. To meet the needs, and the challenge of the climate crisis, the progress foundations have made with regard to their investments must continue and accelerate. ●