Responsible Investment

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What makes a 'good' investment?

Ensuring your investment portfolio isn't harming the world

CharityFinance
SUPPLEMENT

Welcome to Responsible Investment, a *Charity Finance* supplement

It was not long ago that "ethical investing" (as it was usually then referred to) was seen as a fringe part of the investment management world. It usually only involved the screening out of so-called "sin stocks", such as the tobacco, arms and adult entertainment industries. There was also a common view that this approach would limit investment returns.

Over the past few years, the focus on responsible investment has increased considerably. The offering has evolved to move beyond simply excluding stocks, to variously include seeking the best-in-class, shareholder engagement and investing in companies that are actively acting to create positive change.

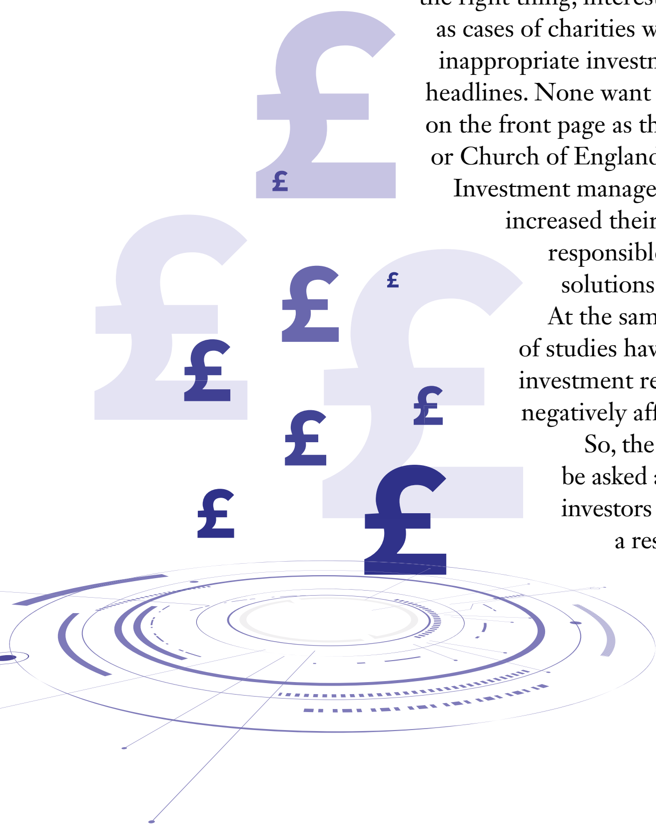
The demand has come from all kinds of investors, but for the charity sector the drive towards this approach is obvious. Charities, of all kinds, are acting to bring improvements to the world. If they have an investment portfolio then it should not inadvertently be causing damage, especially to the specific areas that the charity works in.

Whilst charities undoubtedly want to do the right thing, interest has also heightened as cases of charities with seemingly inappropriate investments have made the headlines. None want to find themselves on the front page as the next Comic Relief or Church of England.

Investment managers have also increased their supply of responsible investment solutions and offerings.

At the same time, a number of studies have shown the investment returns are not negatively affected.

So, the question must be asked as to why all investors have not adopted a responsible portfolio?



There are probably a number of reasons. Firstly, there may still be some lingering concerns about the long-term impact on returns. Understandably, some trustees will be cautious about investments losing value on their watch.

Another factor is confusion leading to inaction. As investment managers have increased their offerings, the same terms are often used in slightly different ways, or different terms are used in the same way. One person's responsible investment is another's sustainable investment and another's ESG investment.

Also, there is the fear that these labels are being used by some to re-market existing products which are not truly modern responsible investment solutions – so-called "greenwashing".

It is a difficult marketplace for the well-meaning investor without specialist knowledge to navigate, but a number of charities will feel that they cannot afford not to take their first steps into it.

The appetite seemingly will grow as time passes, and perhaps more clarity and transparency will emerge as responsible investment becomes more established in the mainstream.

One argument in the market is that responsible investment will naturally become the conventional way of managing investments in the not-too-distant future. The approach involves looking for companies that are well run and have business models that are sustainable in the future, as these are the ones that will provide good long-term returns.

Surely, this description has always been what a good investment manager should be doing for their clients? It is just that as society has changed and as the world responds to the climate crisis, some different filters are needed to judge the best buys of today and tomorrow.

Tristan Blythe Editor, Charity Finance

Doing the right thing – how best to tackle responsible investment

There is debate as to whether it should be mandatory for charities to consider responsible investment, and if divestment of fossil fuel investments is the best policy, says Ian Allsop.

DEVELOPMENTS IN responsible investment (RI) continue to move at pace. And the issues with which it is concerned mean that increasingly RI is set to become more the norm for fund managers, rather than an add-on. For example, while climate change has been a hot topic for a number of years now, the emergence of Extinction Rebellion and in particular Greta Thunberg over the last 12 months have brought it even more sharply into focus.

So much so that Nigel Green, the chief executive and founder of deVere Group, claimed recently that Thunberg was not just helping to save the planet but also was "reshaping the global investment industry". Global research undertaken by deVere Group has found that over three-quarters of millennials cite environmental, social and governance (ESG) investing as their top priority when considering investment opportunities.

He argues that millennials and Gen Z – those born from the early 1980s onwards – seem to "get" the climate emergency we're facing, and the urgency with which it needs to be tackled, far better than older generations. They are going to be the beneficiaries of the biggest-ever generational transfer of wealth – estimated at $30tn – over the next few years. "With their socially responsible awareness, plus their new wealth and power, we can expect them to put ESG issues at the centre of their investment decisions," Green says. "Financial institutions, companies and agencies will need to decisively shift their priorities to match this."

This is as relevant to charity investors as anyone. Twelve months ago, we reported that a group of charities, backed by law firm Bates Wells, had written to the Charity Commission seeking urgent clarification on their legal responsibilities when aligning investments with their charitable objectives. As a result, the Charity Commission has just closed a consultation on the issue.

In January, the regulator's strategic policy adviser Sian Hawkrigg, wrote in a blog post: "Charities are driven by a passion to make the world a better place in line with their purpose and values, so it is reasonable to assume that everything a charity does should reflect this. But, in the area of financial investments, some charities have historically – and understandably – focused on making the best financial return, without taking into consideration all the potential unintended consequences of their investments."

> " It will always be for trustees to decide what is right "

The Commission recognises that there is a need to start thinking more purposefully about how charities invest their funds, as part of its commitment to helping charity to thrive and inspiring public trust. It explains that trustees have a duty to maximise the financial returns generated from the way in which they invest their charity's assets, but that they should also consider whether their investments are consistent with their charity's aims. "As public expectations and attitudes evolve, there are welcome signals that charities are thinking about how to reconcile achieving good returns with responsible investments that align with the charity's mission and purposes. Many in and around the sector are championing this way of thinking and leading the way, but as the regulator we want to understand what is holding others back, and give more charities the confidence to follow suit where possible."

The Commission says it will not be telling trustees what conclusions they should reach when deciding how to invest their charity's assets.

"We want more trustees to feel empowered to take a fresh look at their financial investments and make informed decisions that are right for their charity. Often there won't be an easy answer. It will always be for trustees to decide what is right in their specific case, and what that means in practice will vary between different charities – what is ethical may not always be universally accepted."

RESPONSIBLE DEBATE

While this is a complex legal area, there are varying views on the debate as to whether a responsible approach to investment should be mandatory. Matthew Cox, investment director at Esmée Fairbairn Foundation, links the issue to the failure of regulators around the world to force capital markets to account for non-financial factors, particularly carbon emissions. "This has contributed to the current environmental crisis and the climate emergency that will have consequences across the whole of our society in the coming decades. Responsible investing should be at the heart of our financial system, not an optional consideration. Investors should have an obligation to align their portfolios with the Paris climate accord over the coming decade and to report annually on their progress."

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Interview with ESMÉ VAN HERWIJNEN

Responsible investment analyst – EdenTree

This year is going to be key for climate change, and charities' responsible investment strategies can be part of the solution.

With the United Nations Climate Change Conference (COP 26) nearing, severe weather events causing havoc on a global scale and mass climate change protests, it's clear this year is going to be a key year for action on the environment.

"Climate change is not something that's only going to happen in Australia or some small islands in the Pacific Ocean. It is going to affect all of us," says Esmé van Herwijnen, responsible investment analyst at EdenTree.

> "Climate change is going to be a risk for any investment portfolio"

"From an investment perspective, even if the majority of your investments are only in the UK, climate change is still going to be a risk for any investment portfolio. It is hitting the most vulnerable people, but it is also hitting companies and their supply chains. This will affect companies' physical assets. Do they know whether they are exposed or not? Have they got any mitigation processes in place?

"No matter whether you've already taken a stance on fossil fuels or don't have a policy yet, climate change will still have an impact. The physical risk of climate change will still be there."

TYPES OF RISK

Van Herwijnen says that the costs and disruption of adapting to climate change will impact companies and their investors. "It could be a voluntary transition, but I think it is more likely that we will see this transition risk coming from regulation. That could be because of new commitments made at COP 26 or by individual jurisdictions."

The UK, for example, is the first country to legislate for net zero carbon emissions, and that necessarily means that companies will have to adapt. "What does it mean for their business models?" asks van Herwijnen.

Some business models may not even be viable under new legislation. "There are technological risks – companies and the products and services that they are selling today may no longer be relevant in a net-zero world. Do they need to change their products and services?"

According to Van Herwijnen, an interesting way to look at this from an investment perspective is to think that a portfolio can contribute to the solution. By holding companies that provide services which help to mitigate climate change,

What we do

EdenTree is a pioneer in responsible and sustainable investing, launching one of the first ethical equity funds, Amity UK Fund.

We believe that the companies still making a return tomorrow will be the ones acting responsibly today. That's why our Amity approach to responsible and sustainable investing fully integrates ESG factors across our investment process.

EdenTree is owned by Allchurches Trust Limited, one of the UK's largest grant giving charities. This provides us with a strong and stable base from which we develop long-term partnerships with our charity clients, understanding their needs and helping them formulate strategies in line with their respective values.

edentree investment management

FAST FACTS*

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

*Figures as at 1 March 2020

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or are trying to adapt, investors can help drive positive outcomes for the environment.

"Sectors that lead to resource efficiency, for example, or new energy sources, products and services that have a lower carbon footprint – these are interesting options worth looking at. Regulation could be a driver for change, but it's also really encouraging to see that some companies aren't waiting for the government to tell them what to do. Those are the companies that we are particularly interested in."

SCIENCE-BASED METRICS

The danger of course is that companies can skew data to improve their green credentials or fail to act on prior commitments. Van Herwijnen says that greenwashing can be avoided to some extent by applying rigorous science-based targets.

"For the last four years, we have been evaluating the carbon footprints for our portfolios, where we have measured the emission intensity of the portfolios versus the emission intensity of the benchmarks. And we've used that to identify the highest emitting companies in our portfolio."

This allows the asset manager to exert pressure on companies to operate best green practices. "Globally at the moment, 826 companies have taken science-based climate action and that is clearly not enough. That is why we have engaged with those companies to encourage them to further reduce emissions. Ideally, we need to see all companies make progress if we want to stay within the targets set by the Paris climate accord."

Van Herwijnen says it is key that all the companies in a portfolio are going in the right direction. "Some are more advanced, of course, and already have a large range of products that contribute to mitigating climate change, or are reducing emissions or selling products that have lower carbon intensity. There are other companies that are not quite there.

> "Globally, 826 companies have taken science-based climate action and that is not enough"

"Year-on-year, we can track where they are investing their money, and whether those investments are going towards renewables or whether they are still investing in new coal plants, for example. The companies that we have in our portfolio might not be entirely there yet but, because of the metrics that we are looking at, we can see whether or not they are on the right path.

"Ultimately, when investing for charities, we seek to consider all the risks, including climate change, and deliver our clients profit with principles on their investments."

Anita Bhatia, investment director at Guy's and St Thomas' (GSTT) Charity, favours choice in this rather than compulsion. "We recognise that each charity will balance the interests differently at any point in time and over time. We would advocate for an enabling stance from regulators that encourages engagement with these issues but does not mandate it."

She argues that while charities have been questioning whether there are ways to use endowments – and not just their proceeds – to support charitable purposes, her experience shows that the best outcomes for charitable purposes are achieved when they use all the resources and toolkit available. "As well as using the proceeds of our endowment investing for our charitable work, we endeavour to manage all our assets, including investments and properties, to have the greatest possible positive impact on health."

While responsible investment is now mainstream within the investment community, for Guy Davies, director of Yoke and Company, it should not become a distraction from trustees' focus on running an effective charity, no matter how urgent or important it is deemed to be. However, he adds responsible investment is here to stay for charities, as it morally the right thing to do.

"It is entirely sensible for charities to align their investments to their mission. This is more developed in the pension market, but the UK generally lags behind leading countries, such as Australia or the Netherlands who are leading the way for responsible investment policies."

He points out that the Charity Commission started its consultation with a focus on the legal aspect for charities investing responsibly as there is no formal framework for this in the investment industry. "As responsible investment is quite complex and subjective, it is no surprise many charity trustees have avoided the subject. Furthermore, while the last revision to the Charity Commission's guidance for investment (CC14) was only published in 2016, it is somewhat confusing and outdated considering how fast the debate is moving in other sectors."

Davies thinks that the main barriers for charities to adopt a RI approach relate to a lack of education, notwithstanding fund managers efforts to highlight the subject. "Each manager has a slightly different approach and there are differing methods of measuring the impact of responsible investing. We hope the Commission will be able to shed some light for trustees but suspect they will not be able to be bold with any guidance given the lack of framework."

Kate Rogers, co-head of charities at Cazenove, acknowledges that there are strong opinions both for and against charities being required to invest responsibly. "Some charities point to their duty to maximise returns for current and future beneficiaries. The Schroders 2019 Global Investor Study, which included opinions from 25,000 investors, in 32 countries, reported that 25 per cent of respondents feel prevented from investing responsibly due to the fear of sacrificing financial returns."

> " Responsible investment is now mainstream "

However, she states that there are also trustees who believe strongly that charities, which exist for public benefit, should also be investing with purpose and considering the impact of their investments on society and the planet. "For instance, many have the view that failing to mitigate your portfolio's contribution to carbon emissions is neglecting the long-term impact of climate change on future beneficiaries."

For James Johnsen, head of charities at Church House, there is no doubt that charities and businesses are now more aware of ESG factors when going about their duties than ever before. "As individuals, whether in the home, at work, shopping or eating out, we have become more conscious of where and how our food and products are produced. To this end, when it comes to acting responsibly, the lines have become blurred between corporates and individuals, and our wants and needs are more aligned."

Therefore, it is not unreasonable to expect charities to act in a responsible way that is aligned with their own beliefs, and that should include investing. "The problem for charities (as for the rest of us) has always been the qualification of what represents responsible when it comes to investing. There is no blueprint or universal checklist."

The Charity Commission consultation is very important and timely, according to Stephanie Smith, charity business development manager at Newton, due to the confusion faced by charities as to how they should go about it, what the different terminology means, what effect it may have on their investment portfolio, and how they can accurately compare one asset manager's responsible investment credentials to another's. "The area exercising many trustees' minds is how to balance non-financial impact objectives with the often pressing need to maximise financial returns, including income, in order to fulfil their specific charitable obligations," she says. "This is a subjective and nuanced debate."

Peter Hugh Smith, chief executive at CCLA, suggests that under the current guidance, charities clearly can decide to align their portfolios with their charity's mission and should integrate ESG considerations into their portfolio structure. However, he adds: "It is less clear how radical charities are able to be in taking actions that will benefit future rather than present beneficiaries.

"This is particularly (though not exclusively) relevant to addressing systemic issues like climate change and inequality. It is clear that business as usual will be disastrous for the planet and our communities. Some charities and foundations would therefore appreciate the freedom to take progressive action towards alleviating these challenges, despite the potential for negative evaluations against conventional portfolio metrics like risk and/or return over the short term. We do not believe a trade-off is necessary. However, the feedback from our most progressive clients is that they would welcome increased certainty as to what is really permissible."

Gemma Gooch, head of charities and endowments at BlackRock, says that a number of her firm's clients are looking to implement a variety of different approaches to sustainable investing. "We recognise the increased reputational risk that charities are exposed to with regard to the types of investments they hold and the social contribution that they make. It's unsurprising that we are seeing a dramatically increased focus on the evaluation of responsible, and sustainable, investment policies."

TANGIBLE BENEFITS

So, are there any practical examples of where responsible investment has made a real tangible difference in the last 12 months?

Philip Young, managing director at Close Brothers, cites the oil sector as one where gradually disengaging has made a tangible difference. "The share price of well-known companies has been weak, as we have reduced our weightings not to zero as yet, but certainly to an underweight position compared to the benchmark index. We have been able to replace the income quite easily from other sectors of the UK economy, including the pharmaceutical sector."

Mike Marsham, head of charities at Investec, says that providing charity clients with detail demonstrating the carbon exposure of their investments, has enabled many to satisfy the wishes of their supporters and beneficiaries.

Andrew Pitt, head of charities at Rathbones, feels that companies with strong ESG credentials are showing the benefits of a surge in interest in responsible investment. "Many companies with top ESG rankings such as those that are involved with renewable energy, trade at significant valuation premiums to poorer performers such as coal mining stocks. Some investors have even begun to warn of a stock market ESG bubble. While that may yet happen in due course, we do not think that we are nearly there yet, and this feels like a trend that has a long way to run."

Rathbones has been leading engagement under the banner of the Climate Action 100+ initiative along with several of the largest corporate greenhouse gas emitters. Together they have working to co-ordinate recent shareholder resolutions on climate change. Pitt says: "Royal Dutch Shell, for example, has pledged to halve its entire carbon footprint, including that from the use of its products (which dwarf Shell's own emissions) by 2035. It has also announced its intention to link executive remuneration to this ambition."

Newton is also involved with Climate Action 100+ programme. Smith says that for the first time it co-filed a shareholder resolution on climate change at BP's 2019 AGM with eight other investors. The resolution was supported by BP's management and board. Once approved at the AGM, it required the company to annually set out how it considers its business strategy to be consistent with the goals of the Paris Agreement on climate change, how it evaluates the consistency of each new material capital investment with the goals of the Paris Agreement, and which measures and targets it plans to use, together with the anticipated levels of investment in oil and gas and other technologies, targets to promote operational greenhouse-gas reductions, the estimated carbon intensity of energy products, and the linkage of targets with executive remuneration.

> “Modern slavery is not an issue prioritised by ESG investors”

Modern slavery is on the radar of Hugh Smith. "Eradicating slavery has long been a priority issue for the charity sector, but as it is not likely to impact upon the financial performance of companies, it is not an issue that would naturally be prioritised by ESG investors. For this reason, we have created the Find It, Fix It, Prevent It investor coalition, which is now supported by investors with over £3tn in assets under management and is already leading to changes in companies and regulator action."

Rogers argues: "Sustainable investment is focused on long-term structural change and is difficult to quantify over shorter-term periods. However, one recent example we would like to highlight is the impact of rising carbon taxes on companies' profitability. In 2018, the carbon price more than quadrupled. It is now at the point that is starting to encourage and incentivise companies to switch to clean technology.

"If carbon prices continue to rise, which is something we believe is likely, our research suggests the impact on global profitability could be as high as – 15 to – 20 per cent. Those companies that are already improving their energy efficiency and reducing their emissions will benefit from the competitive advantage of lower costs. Responsible investors who have been actively reducing the emissions of their portfolios will be limiting the impact of higher carbon prices and choosing the winners over the losers."

DIVESTMENT

The campaign against holding fossil fuel shares has prompted many charities to question their approaches. The financial argument against holding such stocks is becoming stronger, particularly if governments implement legislation in line with commitments made under the Paris accord. The challenge for charities which hold their investments indirectly through funds is how best to implement such a strategy.

Bhatia says that the debate about whether investors should divest from or engage with fossil fuels and carbon related businesses seems to have evolved into a deeply complex and inconclusive field of divided evidence and expert opinion. "It is encouraging, however, that charities are actively exploring and scrutinising both sides of the debate. And perhaps there is a third way which is a combined approach to engage with businesses that are changing and to support them on their transitional journey whilst divesting from those businesses that are unwilling or fail to change."

The results of the Newton's 2019 Charity Investment Survey showed that the proportion of charities excluding fossil fuels from portfolios rose from 24 per cent in 2016 to 32 per cent in 2019. However, Smith argues there is no right or wrong p34 ▸

Interview with IAN CHESHAM

Director, Charities Team – Barclays Private Bank

Investing has evolved beyond traditional ethically screened portfolios, offering charities opportunities to make positive change.

A few years ago, the conversation was all about impact investing but, recently, discussions have shifted more towards responsible and sustainable investment strategies. "Our sustainable investment strategy has outperformed its benchmarks, its peers, and delivered high market returns," says Director in the Barclays Private Bank Charities Team, Ian Chesham. "But, once certain barriers are overcome, I can't see why this can't also be the case for impact investing. The opportunities we are seeing now are global and exciting, and present a real chance for charities to make a difference."

> "The opportunities we are seeing now are global and exciting"

Chesham says that for those looking to make intentional, positive change, impact investing can be a powerful vehicle. But, he cautions, there are several factors to consider. "Impact investing is a very different animal from responsible investing. Some of the terms can be very confusing. Investors need to cut through the jargon and demystify what impact investing is and what opportunities it presents," he says.

To this end, Barclays launched a national campaign to inform investors about Environmental, Social and Governance (ESG) and impact investing, explaining terms and strategies.

Chesham says: "I think there is a strong willingness to learn but, at the moment, many charities are simply unaware of the opportunities out there and without in-house expertise on the topic it is important to work with investment managers. It is a steep learning curve."

BREAKING DOWN BARRIERS

As well as getting to grips with the terminology, there are other barriers to accessing impact investment. "With liquid investments, you can access your money quickly, but with true impact investments, which are often illiquid private assets, sometimes it is a ten-year commitment," says Chesham. "A charity has to consider whether it has the reserve policy that fits this type of strategy, as well as the cash flow."

Access can be difficult, but there are a growing number of opportunities where you can have a societal and environmental impact while at the same time achieving an attractive market return, according to Chesham.

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 manages in excess of £100bn in client assets
- Over one fifth of the largest 5,000 charities in the UK bank with Barclays

*Figures correct as at 31 December 2019

To help charities take advantage of this, Barclays has established two programmes in the impact investment arena: Unreasonable Impact, which focuses on scaling entrepreneurial businesses that are working to solve some of the world's most pressing social and environmental challenges; and another impact programme that connects companies and venture capitalists with investors to create a forum and investment platform.

"Through Unreasonable Impact alone, we have partnered with 124 companies, creating 20,000 new jobs, with an estimated 187 million people positively impacted," says Chesham. "It just shows that if you have investor capital reaching companies which are scaling up and making seismic changes to the world, you can really make a big difference."

FINDING THE PERFECT MATCH

Chesham says that Barclays is seeing a wide spectrum of charities of all sizes undertaking impact investing, and those tend to be the ones that are more forward thinking.

"A charity's ethics and values are always the starting point – what are your beliefs, your mission and your investment goals? Previously, there used to be an investment pot that was there to maximise return, and the rest of the organisation only saw profit or loss, but now a charity's values are core to its investment strategy."

Indeed, investment strategy is now very much part of a charity's public persona and a way of gathering support and acquiring donors. "It has become a powerful tool for a charity to enhance its reputation and reduce reputational risk."

Impact strategies don't have to be high risk in terms of returns either, says Chesham. "For example, we have fixed income investments that are focused on impact which are lower risk than private equity."

> "A charity's values are core to its investment strategy"

Chesham cites projects around solar energy and reforestation, which have proved solid performers. "Once platforms are built and access to companies and investment ideas are available, then impact investment will only grow; the number of opportunities is huge and the demand is huge also."

A vital part of the strategy, says Chesham, is to pair the right charity with the right opportunity. "You should never forget that charities have their own direct social impact and the reserves are there to support that work. But, if your investments are aligned with those impact goals, then the difference you can make is enormous."

approach. "Each has its own merits and will be dependent on what works best for the charity."

Rogers adds that activist investors' attention is going beyond big oil companies and refocusing on the financers of the industry, in particular the large banks. "A number of our clients have co-signed resolutions asking major banks to commit to reducing the financing of the fossil fuel industry."

Pitt states that engagement with fossil fuel companies and exercising shareholder rights potentially provides a powerful motive for change and many charities choose to exercise their shareholder rights to call for this. "There is certainly a strong argument that a shareholder is well-placed to conduct a constructive dialogue with company management to achieve a meaningful change of direction in the fight against climate change."

He adds: "Fossil fuel companies' massive cash flows and assets can, of course, provide much needed capital to help develop climate change solutions. These companies are among the largest investors in renewable energy and related areas, although given the relative sizes of renewable energy, transition technologies and related areas, these investments are still small in the context of their overall businesses, albeit increasing quickly. As the economics of renewables continue to improve, investments into these areas will increase even faster."

Johnsen says that the world is changing rapidly, and digital and technological advancement is constantly opening our eyes to new opportunities and threats. "It is easy to simplify the divestment debate. Completely selling out of several companies and buying others does not necessarily represent a good ethical decision. It is important to take into account how divestment (if needed or desired) would affect the overall portfolio if put into effect over a short space of time.

Trustees absolutely see the benefits in divestment but are taking a pragmatic approach based on many factors. After all, they are not just tasked with looking after the immediate needs of a charity, they must also think about future earnings and the effect on their cause should earnings suffer."

GREENWASHING

Greenwashing, the "process of conveying a false impression or providing misleading information about how a company's products are more environmentally sound", is one accusation that has been levelled at firms in the fund management industry. In November 2019, the FCA was urged to take action against the UK ethical investment sector.

Wealth manager SCM Direct examined a number of areas, including fund holdings and the classification of ethical funds on direct-to-consumer platforms. It argued that misclassified funds are being mis-sold to the UK public. Some high-profile funds were revealed to have notable exposure to sectors like tobacco, gambling and defence.

"The ESG sector is akin to the Wild West, yet once again the UK regulator, just as it with the recent Woodford scandal, appears to be asleep at the wheel, failing to protect the British public," said Alan Miller, co-founder of SCM Direct alongside his wife, Brexit campaigner Gina Miller.

> "The ESG sector is akin to the Wild West"

So how can charities cut through the marketing from fund management firms? Cox acknowledges that this is a challenging area and that it is hard for charities to identify greenwashing without the help of external expertise, particularly in areas like fund selection.

Bhatia adds: "In our experience, a robust due diligence framework and monitoring plan can be very effective in weeding out managers that may be greenwashing their strategies. We have a layered approach, using both internal and external expertise to scrutinise each investment opportunity. We analyse investments rigorously from different perspectives (financial, operational, impact). We try to verify information received from managers independently where we can. All investments are reviewed by a separate investment committee of distinguished experts in their field.

To this end and indeed in monitoring investments, it is very important that managers are open and transparent with information about their portfolios and organisations."

Davies recommends that charities ask some simple questions of their fund manager, such as the amount of funds managed with some ethical overlay as a percentage of total assets under management. He continues: "How many staff are directly employed in responsible or sustainable investment? Are they signatures to the UN PRI, and if so, what is their overall rating? How do they evaluate companies' ESG score, and which vendors do they use to do this? What is the manager's policy on engagement, and what evidence do they have in voting at company meetings? What is their staff diversity policy, and evidence of equality?"

Over time, certain fund managers will emerge as leaders for responsible investment, with ESG as a core to their process and philosophy, he says. "Whereas financial performance is based upon proprietary insights, responsible investment performance is based on sharing insights. The fund management community can really struggle with working with its peers, and bizarrely, such a lack of collaboration might be one of the most effective ways of identifying greenwashing."

LOOKING AHEAD

While many charities regularly review their investment manager and arrangements, they often fail to review their responsible policy, if they have one. As the debate about RI investment evolves, so should the policy. What was right when the policy was first agreed upon may not be as relevant a few years down the line.

Davies concludes that the growth and popularity of RI has coincided with the longest economic cycle in history, combined with a long bull run in equities, and that the current environment will now really put it to the test. "Fund managers who follow an investment policy of investing into quality growth

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Trustees should get to grips with ESG investments

BRIDGIT RICHARDS
Director of product and marketing – CAF

Responsible investments can deliver returns, while remaining consistent with a charity's mission and core values.

What does responsible investment mean to charities?

It's hard to ignore the growing noise about Environmental, Social and Governance (ESG) factors in investments. As charities, we naturally always want to do the right thing in our investment decisions – the right thing for our mission, the right thing for those we support and the right thing to give us good returns for the future.

Deciding how we invest charitable funds is a central role for many trustees and defines how we see the future.

The term "responsible" can cause confusion. Is it the same as ethical, sustainable, impact, carbon offset and ESG? The Investment Association's recent work on definitions is a great starting point for charity leaders.

The Charity Commission, in its CC14 guidance to trustees on investments, states that charity leaders should seek to maximise returns from investments, while maintaining an appropriate level of risk. But the Commission has also spoken recently about the ways in which charities can invest to support their mission. In the past, the choice to invest in so-called ethical investment products was often seen as coming at the expense of investment performance. However, recent research findings have challenged this, with some responsible investments delivering results that meet or exceed their benchmarks or conventional equivalents.

> “Trustees have a duty to ensure their investments are prudent”

What do trustees need to think about?

Trustees have a duty to ensure their investments are prudent, appropriately managed and have the right level of risk for their organisation to produce the required level of returns. They have the flexibility to restrict or include those investments that might conflict with their mission or further it.

They are also able to take a view on what their beneficiaries and donors might expect them to do. Common examples are health charities screening out tobacco stocks or environmental charities removing fossil fuel investment.

Climate change is a key topic as it affects everyone, so trustees may want to think about whether their supporters might reasonably expect them to exclude damaging industries from their portfolios. It is important to take a reasoned decision, based on the information available, and record it in an investment policy. This can be helped by seeking the advice of an investment adviser or similar professional, although potentially at a cost.

What we do

Charities Aid Foundation (CAF) has been helping charities manage their investments for over 30 years. And because we are a charity too, we understand the way charities work, the challenges they face and the vital role that good governance plays in charities' success.

CFSL is a subsidiary of Charities Aid Foundation (registered charity number 268369). CFSL is authorised and regulated by the Financial Conduct Authority under registration number 189450. CFS's registered office is 25 Kings Hill Avenue, Kings Hill, West Malling, Kent ME19 4TA. Registered under number 2771873.

CAF
Charities Aid Foundation

FAST FACTS

- CAF Financial Solutions Limited (CFSL) offers a range of investment solutions. These include socially responsible funds, a managed portfolio service and a charity investment platform.
- It also offers deposit products, developed specifically for charities with selected financial services partners.
- To find out more, visit www.cafonline.org/charities

Is responsible investing a fad or is it here to stay?

Responsible investing reaches far deeper than just opportunities for profit. It is about how companies and governments treat people, the environment and trade so the profits they generate are obtained in a fair way with as little as possible, or no, collateral damage.

Rising public recognition and strong opinions, especially among younger generations, will influence how companies and governments behave in the future. Recent comments by Mark Carney, former governor of the Bank of England, have introduced the idea of stranded assets – assets that have a value now but may become isolated as investors shun them in favour of more responsible alternatives. Crude oil and coal are examples.

When comments such as these are commonplace, there is a sea change in the way the investment industry operates and that may, in turn, have a significant impact on company behaviour. Good companies with strong, responsible policies and evidence of positive impact will likely attract more sustainable business.

> “Responsible investing reaches far deeper than just opportunities for profit”

How should charities approach responsible investing?

The key is to decide on a policy for your charity. Even when the merits of a specific approach are agreed, it will be difficult to implement, unless a charity has the skills or the assets to create a portfolio tailored to their requirements. Most investors will need to look to funds that support a responsible investment approach. The charity, or their adviser, needs to identify a fund that adopts a close fit to their requirements, while still providing good financial return potential.

With funds, a pragmatic approach by both managers and investors has to be adopted. Until common definitions are agreed, it is going to remain challenging to adopt a purist approach to exclusion.

Charities should also be wary of investment solutions that are only responsible in name but not in substance, often called “greenwashed” products.

Responsible investing has been well established for many years and is moving from a niche role into the mainstream. Charities need to take the time and effort to understand the fundamentals of any investment opportunity, and look at the detail below the responsible label to see if it is consistent with their values and mission.

companies have performed well in recent years. It will be interesting to see if this trend continues if we see an economic downturn.

"The current COVID-19 scare has had a sudden and dramatic impact on share prices and economic outlooks. Fund managers have argued that well-run companies, with high ESG scores, will perform better in periods of economic weakness as their cost of capital is generally cheaper and they will be rewarded in the long term. The quality growth and responsible investment approach that most fund managers now promote will be finally be put to the test in 2020."

DEVELOPMENTS AMONG LEADING CHARITIES BY FUM

Church organisations

In 2018 the Church Commissioners for England's in-house engagement team engaged directly with 78 companies through 107 engagement interactions. While its key responsible investment priorities include the environmental and social performance of extractive industries, human rights, corporate tax, responsible alcohol marketing, executive remuneration and diversity, its pre-eminent focus remains climate change and ensuring that companies align their strategies with the requirements of the Paris Agreement. In February, the Church of England's General Synod set new targets for all parts of the church to work to become carbon net zero by 2030, 15 years ahead of the original proposal.

In September 2019, the Church Commissioners announced the expansion of their corporate engagement team and the appointment of an external engagement provider as part of "ambitious plans to influence companies on high profile ethical and ESG issues".

Meanwhile last month, the Church Investors Group (CIG), representing 70 members (including the Church Commissioners, the Church of England Pensions Board, the CBF Church of England Investment Funds, and the Central Finance Board of the Methodist Church), and £21bn in assets, wrote to the leaders of FTSE 350 companies to inform them that the group will be enhancing its scrutiny of corporates' ESG aspects this AGM season.

The CIG already holds companies to high standards on executive pay, boardroom gender diversity, climate change and tax justice. It regularly votes against executive remuneration schemes and votes against the reappointment of directors when pay schemes are particularly excessive. This year, new measures extend expectations on diversity and holding directors to account on modern slavery.

Now, the CIG will incorporate into its assessment: a review of director remuneration ensuring the company's policy is consistent with its stated approach to climate change; a review of auditors' reports to ensure they have not failed to identify and communicate to shareholders the risks associated with climate change, and an analysis of any political lobbying or trade association memberships that run contrary to the company's stated position on climate change.

National Trust

The National Trust announced in July 2019 that it will cease any investment in fossil fuel companies, and introduced a series of measures to ensure its investment strategy continues to support its aims as a conservation charity. Previously the Trust had required that no investment be made directly in companies which derived more than 10 per cent of their

What do you think has been the major change in how charities approach RI in the last few years?

"It's moved from a 'nice to have' to a 'must have'. Managers are under greater pressure to clarify and prove their stance to trustees. Trustees do want to maximise financial returns from investments but it's not their only goal as has often been the perception. Aligning with their charitable cause is often a key consideration."

James Johnsen, Church House

"In 2009, just 23 per cent of charity investors had a policy that linked their investment strategy to their charitable aims. Now more than three-quarters seek to align their investment approach with their aims – both avoiding areas of conflict and seeking positive impact. There are a number of explanations for this, from the need to guard reputations and build public trust in the face of increasing press scrutiny, to the increasing evidence that investing sustainably enhances returns. And many charities want to feel assured that their assets, much like their activities, are creating positive outcomes for people and the planet."

Kate Rogers, Cazenove

"The most striking change we have witnessed is the growth in understanding of the value of responsible investing – not merely as ethical overlay but as a potential driver of positive financial returns."

Peter Hugh Smith, CCLA

"Five years ago, not many charities would have considered not holding fossil fuel investments at all in their portfolios, mainly but not exclusively because of the impact on the income generation. Now a zero weighting, while certainly not a default position, is becoming much more a mainstream view, as the agenda has moved on."

Philip Young, Close Brothers

"Charities have become more aware that many investment managers are using RI as a marketing tool to raise new turnover from the extraction of thermal coal or oil from oil sands. The new measures include:

- Divesting from all fossil fuel companies within the next three years;
- Establishing a long-term goal to continue the reduction of the carbon footprint of the investment portfolio;
- Increasing engagement with companies invested in, to encourage them to make material improvements in their environmental performance;
- Actively seeking out opportunities to support green start-up businesses.

"In short, we're removing fossil fuel investments and increasing investments in green businesses of the future," says chief financial officer Peter Vermeulen. "We gave ourselves three years because the experience of others told us this takes time, but we also wanted investment firms to be given the opportunity to redesign their investment vehicles so we can remain invested with these managers, and give other investors access to more products that exclude fossil fuel investments. I'm pleased to say we're having a good response to this. We have also launched a £30m private equity fund that looks to invest for both financial return and environmental benefits, supporting new start-ups or growing businesses. We also continue to reduce the carbon footprint of our investment portfolio, and have included the footprint of investments in our target to be net zero by 2030 as an organisation."

Nesta

Nesta was one of the original charities in the coalition calling for Charity Commission clarity on RI in March 2019. It published its own RI policy in its 2018/19 annual report and accounts. "Nesta believes that responsible investment can enhance long-term portfolio performance. The process of incorporating a more responsible approach to investment involves:

- Some limited exclusion of stocks where Nesta objects on moral grounds to the activity of the company in question;
- An explicit programme to monitor fund managers' incorporation of ESG factors and their practice of active ownership and stewardship;
- Adoption of the Hermes Equity Ownership Service for our index investments;
- Continuing support for impact and venture capital investments;
- Research and advocacy to ensure company managers are rewarded for promoting positive innovation.

"These policies have informed Nesta's actions, oversight and asset allocation decisions. However, it should be noted that such initiatives take time to fully implement and Nesta may have some holdings that do not fully accord with its responsible investment policies. These will be run down over time. The RI policy remains under constant review."

Barts Charity

Barts clarified its responsible investment position in its most recent annual report and accounts. "We recognise the importance of ethical investing. The approach taken by fund managers to the ESG aspects of assets is increasingly taken into account as part of our diligence and monitoring process."

Steve Harris, chief finance officer, says that the statement better reflects what Barts is aiming for through its investment philosophy. "We are continuing to develop our approach to ESG investing and will be finalising an updated policy later this year." ●

money rather than something that is strongly aligned with their culture and beliefs."

Matthew Cox, Esmee Fairbairn Foundation

"What seems remarkable is that even in the absence of a clear and homogenised policy on RI, many charities have nevertheless started a journey to explore industry definitions and practices, and how these might be integrated and implemented into an investment approach. Charities have been some of the first and most enthusiastic supporters of RI given its alignment with public benefit "

Anita Bhatia, Guy's and St Thomas' Charity

"Generally speaking, charities have wanted to invest in a responsible manner for many years. The amount of data now available on non-financial metrics by which to view companies has increased significantly, enabling responsible investment strategieto be applied with more rigour."

Mike Marsham, Investec

"We have seen a shift in the importance placed on asset managers' responsible investment credentials. It is no longer enough that an asset manager is a PRI signatory. There is an increased focus on exactly how asset managers incorporate ESG considerations into the investment process and how they are acting as stewards of their clients' assets in terms of engagement and voting."

Stephanie Smith, Newton

"The major change has been a move away from merely screening out certain types of investment that may be in conflict with the aims of the charity, to wishing to invest only in companies that demonstrate sound ESG credentials. Charities also increasingly expect their investment manager to be an active voice for them."

Andrew Pitt, Rathbones

"There has been a stark change in the public trust in charities in the last five years. While this is largely related to safeguarding, executive pay and other governance issues, increasing numbers of supporters are asking where charities are investing and encouraging divestment of controversial sectors or stocks."

Guy Davies, Yoke & Co

Interview with ALEXIA PALACIOS

Analyst, responsible investment – Ruffer

Engagement is a key tool to driving lasting and positive change when it comes to responsible investing.

Increased pressure from both the public and shareholders has contributed to companies beginning to realise that it is in their best interest to engage with investors at a deeper level.

"Companies, particularly over the last few years, now see it as beneficial to understand their shareholders' concerns so they can better address them," says Alexia Palacios, analyst in responsible investment at Ruffer.

> "Getting companies to set targets and improve their disclosures helps investors"

"The conversation around social and climate issues, for example, is moving so fast that companies feel that they need to demonstrate that they are managing these risks and opportunities appropriately. It can be very damaging to a company's social licence to operate if they don't appear to be addressing these concerns."

LEVEL OF ENGAGEMENT

Despite these advancements, Palacios says that the level of engagement still depends on the company, the industry it is in and where it is located.

"Traditionally, companies in some jurisdictions, such as Europe, have tended to be more open than companies in other jurisdictions," says Palacios, who joined Ruffer in 2014. "But when we talk about engagement, it is important to understand that it is not a linear process. Sometimes you make progress, but then a company may dig in its heels and the conversation stutters.

"It is essential that we can see a clear direction of travel. It is about finding a way to work with each other to understand the challenges the company faces and have detailed conversations about the underlying factors that are driving decisions."

Charities and their asset managers have a duty to behave as responsible stewards, Palacios says. She believes that encouraging companies to set targets and holding them accountable for achieving them is vital for progress.

The way engagement is being structured recently is much clearer, says the responsible investment analyst. "Getting companies to set public targets and to improve their disclosures helps investors determine whether these companies are committed to those goals and making real progress."

This can be amplified through collaboration, suggests Palacios. "It is a valuable tool to achieve

What we do

At Ruffer, we have a distinctive approach to investing, which we believe is well suited to the needs and goals of charities and their trustees. We focus on delivering 'all weather' investment returns and protecting and growing the value of our clients' assets throughout the market cycle. Instead of following benchmarks, we aim not to lost money in any single year and to deliver a return significantly greater than the risk-free alternative of cash on deposit. By aiming to avoid the cyclical gyrations of the market, we aspire to provide a less volatile experience for our charity clients.

Ruffer LLP is authorised and regulated by the Financial Conduct Authority.

FAST FACTS*

- £19.5bn in assets under management
- £1.5bn entrusted to us by charities
- 300 charities

*Figures as at 31 January 2020

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real change when companies see their investors come together with one voice to push them to do more in a particular area. I think that collaborating to achieve the same objective is incredibly powerful."

COLLECTIVE VOICE

One example of how collaboration can effect change, she says, is Climate Action 100+, which is one the largest investor initiatives to tackle climate change to date. Ruffer was one of the founding signatories of the initiative, which is now supported by 450 investors with more than $40tn in assets under management.

The aim of the project is to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change through three defined goals: 1) Implement a strong governance framework that clearly articulates the board's accountability and oversight of climate change risks and opportunities; 2) Take action to reduce greenhouse gas emissions across the value chain, consistent with the Paris climate accord; and 3) Provide enhanced corporate disclosure.

"The scale of this initiative gives considerable power to investors, and creates a valuable opportunity to exert continued pressure on companies to align their business models to transition successfully to a low-carbon economy," Palacios says. "The companies this initiative is engaging with are of great importance, given their combined greenhouse gas emissions; their actions will have a meaningful effect on whether the goals of the Paris Agreement are met."

Palacios says most charity trustees are on the same page. "They are passionate about ensuring that the assets of the charity are being invested responsibly. But, for some charities, it is not possible for them to engage with companies themselves."

> "Collaborating to achieve the same objective is incredibly powerful"

What trustees can do, she says, is ensure that their asset managers are incorporating Environment, Social and Governance (ESG) considerations into their analysis and the stewardship of their investments and keep the pressure on companies to change. "The pace of change in this area is energising, and there is considerable momentum that has already led to some significant commitments by companies.

"There is still much work to be done but we think that engagement, often through collaborative initiatives, is the best way to encourage companies to adapt their business models to enable them to be a positive force for change."

Interview with NANCY KILPATRICK

Head of unit trust relationships – Legal & General Investment Management

As ESG investment strategies become more mainstream, charities need to be clear on what they are trying to achieve.

During her 18 years in investment management, head of unit trust relationships at Legal & General Nancy Kilpatrick has seen her fair share of emerging trends, but the recent surge in Environmental, Social and Governance (ESG) investment strategies has been particularly noteworthy. "Responsible investing has gathered pace quite markedly over the last year or two," she says. "And, equally, the ESG investment industry has grown enormously, hitting its first $1tn globally last year."

> "Responsible investing has gathered pace quite markedly over the last year or two"

Kilpatrick says the investment landscape has moved on from purely the exclusionary towards ESG being a more mainstream and a positive contributor in driving change. "Early versions of ESG investing were based purely on ethics and negative screening. Trustees would come at it from the point of view of not wanting to be criticised and to avoid clear risks. But the rhetoric has changed. It is not so much about just avoiding the negative; it is about seeking the opportunities in the positive."

WOOD FOR THE TREES

This shift, however, has lead to some ambiguity. Choosing not to invest in an arms manufacturer or a tobacco company is a clear moral decision, says Kilpatrick, but, when it comes to the wider concept of responsible investment, waters are more muddied.

"Trustees are best placed to decide what is right for their charity based on its core values, but when we start to talk about positive impacts on topics outside of the charity's remit such as climate change or social issues, I think there is some confusion about what that really means," she says. "There is confusion around whether you should sacrifice financial return, how individual investment managers approach ESG and how success can be measured."

One reason why this presents challenges for decision makers is simply because of the sheer number of companies and funds that fall into the ESG category. Research by Legal & General using Morningstar as an aggregator in the UK equity space found over 250 different funds that are labelled

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
- 48,000 votes cast in 2018 alone

*Figures as at 31 December 2019

ESG – each doing things slightly differently.

To navigate this, trustees and finance directors need to rethink their approach to the debate. "The conversation has to be more around what are you trying to achieve when it comes to something such as climate change," says Kilpatrick. "You might just want to wash your hands of the risk of being associated with the energy industry or oil and gas companies and divest, but that does not really feed into the narrative about how we are going to move to a lower-temperature environment. In fact, by divesting, you could very easily be increasing holdings in companies that are financing the activities of the fossil fuel industry, depending on how far down you dig."

SUSTAINABILITY IS KEY

To help focus some of the thinking around ESG investing, Kilpatrick suggests trustees should be looking at sustainability as a key indicator. "The big idea underpinning ESG investing and why it has become so popular is that companies engaged with it are, ultimately, better run. If you address Environment, Social and Governance issues and future proof your company, then you end up generating returns for investors for longer, which in turn feeds into long-term financial sustainability."

The role of a fund manager in all this, says Kilpatrick, is to avoid knee-jerk reactions and gather as much data as possible to steward assets effectively. "This can be tricky with ESG as a lot of data isn't readily available as yet, but transparency is really key. We push for the utmost disclosure of data. A company cannot truly be assessed until you are aware of the starting point. Then you will be able to track progress."

> "Trustees need to ask whether their fund managers are helping to drive positive change"

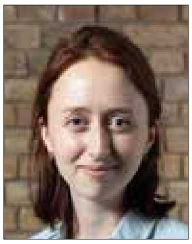
Trustees also need to ask whether their fund managers are helping to drive positive change in the organisations in which they are invested. "Trustees need to know how their manager is using their shareholder power for maximum impact. Are they engaging with companies, meeting with them and talking about ESG issues?"

Responsible investing is new and it will get easier as more data becomes available and metrics devised, says Kilpatrick. "But one thing is for sure: it is not just something nice to have in your investment strategy any more; it is becoming a serious concern."

Two levers to align investments with a charity's mission

Charities can ensure their investments align to their cause and create changes in the world though shareholder engagement, says Lily Tomson.

"WE HAVE TO LEARN TO ROBUSTLY ENGAGE WITH OUR ASSET MANAGERS AND UNDERLYING COMPANIES"



Lily Tomson *is head of networks at ShareAction*

CHARITIES HAVE huge potential to achieve their charitable objectives through their investments, alongside their operations or grantmaking. Crucially, we can do much more than divest to achieve our charitable objectives.

Charities have two levers – asset selection and engagement. There's a common misconception that we can only do one or the other – ie, that we can divest or we can engage. This can lead to "analysis paralysis" around fossil fuel divestment (and thus responsible investment more widely). Most charities have failed to mobilise their investments as a whole to drive their charitable objectives, whether we've divested or not.

As responsible asset owners, charitable investors must pull both levers to achieve significant real-world impact through our investments. We have to learn to robustly engage with our asset managers and underlying companies, as well as making purpose-led decisions about our holdings.

THE ENGAGEMENT LEVER

Most charities understand the engagement lever less well, and critically haven't learned that they can have the most impact through working in concert. This led a group of charities to form the Charities Responsible Investment Network (CRIN) as a space to learn and act together. The group now contains 20 members of varied sizes and thematic interests, united by an engagement with responsible investment. In this article, we learn from a few leading charitable investors about how they're pulling the engagement lever to achieve impact through their investments.

Charity responsible investment starts at home – by ensuring that your asset manager/s are providing high quality responsible investment outcomes that align with the objectives of your charity. CRIN members created *Improving the Conversation* as a set of expectations around the responsible investment processes of their asset managers, with a particular focus on public equity. This has spawned a diverse range of member approaches to asset manager engagement, with a common focus on process quality.

> "We can do more than divest to achieve our charitable objectives"

As Aidan Kearney, chief investment officer at the Health Foundation, says: "We have increasingly engaged with our selected asset managers not just on matters of performance but on issues around each aspect of the environmental, social and governance elements of ESG. Each asset manager is required to have their own policy in place detailing its approach to responsible investing beyond share price performance, but we also want to ensure that this is not just outsourced box ticking around proxy adviser guidelines, but rather their own considered and properly resourced process to deal with these matters. Our engagement with them in this area is expanding and I have little doubt they are experiencing this from other asset owners too."

Just as charities can often engage most effectively by working together, the Joseph Rowntree Charitable Trust (JRCT) believes the same principle applies to its asset managers. JRCT's head of finance Jackie Turpin explains: "We expect our asset managers not only to engage but also to engage as effectively as possible. On a number of occasions, we have brought all our asset managers into a room together to discuss issues of particular concern to us, for example the gender imbalance in the asset manager industry and the implications of technological development for corporate accountabilities. We also encourage them to form coalitions with other asset managers to strengthen their engagement impact, particularly where access to company management is limited, such as in the case of big tech companies."

Charities have a wide range of objectives, and there are responsible investment engagement options to suit all of them. A rising topic of concern is the impact of the transition to a low-carbon future on social issues, and especially communities "left behind", or indeed negatively affected by the poor workforce practices of new industries.

Jonathan Gillett, trustee of the Polden-Puckham Charitable

Foundation, says: "Our policy challenges our asset managers to go further and faster in aligning our portfolio with the need to reduce carbon emissions by 50 per cent by 2030 to attempt to keep under 1.5 degrees of global warming. Given the huge transition required, trustees are concerned that no section of society should be unfairly disadvantaged, and we thus signed the *Statement of Investor Commitment to Support a Just Transition on Climate Change*. We are now working with our asset managers to see how this can be put into practice through investment strategy, corporate engagement, capital allocation and policy advocacy."

DIRECT ENGAGEMENT

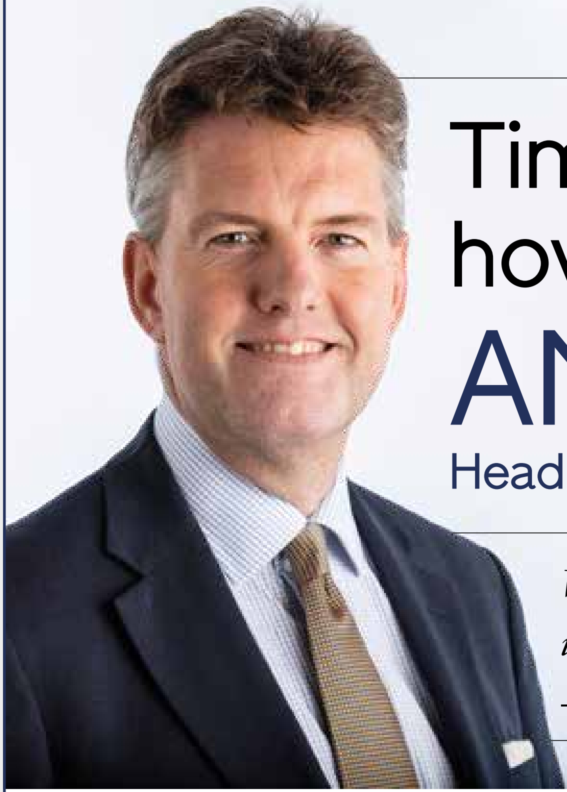
Another tool that charities have at their disposal is to engage directly with the companies that they hold, on issues that affect their charitable objectives. CRIN members Lankelly Chase and Jesuits in Britain were among a group of investors that filed a shareholder resolution for the 2020 annual general meeting of Barclays, asking the company to align its fossil fuel lending with the Paris Agreement.

"This is the first climate-related resolution to be filed at a European bank, recognising the importance of aligning the financial sector with the goals of the Paris Agreement and avoiding catastrophic climate change," says Dominic Burke, investment director at Lankelly Chase. "Lankelly Chase and Jesuits in Britain are engaging directly with the board of Barclays, as well as collectively with our common investment managers to seek their support for this landmark resolution."

> "Charities can often engage most effectively by working together"

As well as engaging with asset managers and directly with companies, charitable investors can also pull the engagement lever to influence behaviour at regulators and other bodies to achieve change. Mark O'Kelly, director of finance and administration of the Barrow Cadbury Trust, says: "Our investment manager, Sarasin & Partners, has coordinated investor letters to the 'Big Four' audit firms, encouraging them to challenge management assumptions and ensure that material climate risks are incorporated into company accounts. This could potentially impact on the share prices of companies and drive internal change. Both the Financial Reporting Council and International Accounting Standards Board have recently reminded companies and auditors of the importance of reflecting climate risks in the financial statements."

Through engagement with asset managers, companies, and regulators, members of the CRIN are using shareholder action as a tool to drive forward their charitable objectives. We encourage other charity investors to develop investment policies which realise the potential of their investments as a route to achieving, as well as financing, the change they want to see in the world. To do this most effectively, charity investors should act together. ●



Time to rethink how we invest

ANDREW PITT
Head of charities – London, Rathbones

When it comes to tackling the world's most pressing issues, capitalism isn't the problem, it's the solution – when pursued responsibly.

What is behind the growth in responsible investing?

Since the end of the global financial crisis, markets have been on one of the longest bull runs in history. Yet, as wages stagnate, productivity slumps and living standards drop, large swathes of people in Western democracies feel left behind. The incremental return on investment has plunged and inequality has risen. That lowers economic growth further because the average worker has a higher propensity to spend additional income than the average wealthy capital owner.

Capitalism is delivering returns for shareholders, but not in a sustainable way if stakeholders – employees, customers and the wider world – aren't sharing in the benefits or worse, if they are paying a cost for delivering those returns. Many have lost trust in capitalism itself.

Executives and investors must consider a new approach, one that acknowledges that long-term profits depend on a diverse, thriving ecosystem. One that acknowledges that a healthy, well-paid, socially mobile workforce matters for market size and productivity; that insurance losses from climate change-related events have increased fivefold in recent decades and that the environment and financial stability are connected; and that companies are better off prioritising basic research and investment over financial engineering. Capitalism isn't the problem, it's the solution – when pursued responsibly.

> “Businesses with the most sustainable practices are better performing”

What are the main challenges around this type of investment?

There are challenges in operating a detailed stance on Environmental, Social and Governance (ESG) considerations for firms that treat each client individually, with their specific needs and requests met. Our equity research analysts incorporate an evaluation of governance risk as part of their investment case, using non-financial data and information, and this is debated as part of our stock selection process. Interestingly, over time, various social and environmental issues have become governance issues, as governments have begun bringing in legislation in areas such as carbon footprint, gender pay gap reporting and supply chain transparency.

Most of our charity clients are long-term investors. Many are endowments with infinite time horizons. Therefore, we must ensure that we do not diminish the investment returns of tomorrow, which are intimately linked to the investment decisions of today. Although there is actually a now substantial body of evidence to suggest that businesses with the most sustainable practices are better performing than their peers.

What we do

We like to work in partnership with our charity clients which means you have direct access to the person managing your charity's investments, resulting in a portfolio that accurately meets your needs and is as individual as your charity.

For further information, please contact Natalie Yapp:
E: natalie.yapp@rathbones.com
T: 020 7399 0128
W: rathbones.com/charities

Rathbones
Look forward

FAST FACTS*

- £6.1bn of charitable funds under management
- Over 1,900 charity clients
- Segregated or pooled investment
- Dedicated team of charity investment specialists
- A history grounded in philanthropy

*All figures as at 31 December 2019

Where do you expect to see the most growth?

Society faces massive challenges – dwindling natural resources, climate change, and increasing inequality of pay, just to name a few – and people are demanding change. This is a massive opportunity for companies that can find sustainable solutions to our environmental conundrums, address inequality and offer sustainable products to clients who vote with their wallets. And this is no niche market – the Business and Sustainable Development Commission estimates that achieving the UN Sustainable Development Goals will create at least $12tn in market opportunities.

We believe investing in firms with a solid purpose can deliver benefits to society, as well as maximising returns to shareholders. Capitalism has a future if it reconnects with this founding purpose and if shareholders are encouraged to act with a view to the longer term. As long-term investors, we must seek to do what is in the best interests of our clients. This includes investing responsibly, thinking through the true long-term costs of all assets we invest in and seeking sustainable returns. Societal problems and investment returns are intimately linked; the solutions for society and investors are one and the same.

Interest in joining collaborative engagements is growing across the business, our industry and the wider world. I am excited to see the impact we can have by engaging more staff on these issues and the opportunities we have as investors.

> “Society faces massive challenges and people are demanding change”

What is Rathbones' involvement in the PRI?

Our involvement with the Principles of Responsible Investment (PRI) goes back to 9 September 2009, when we wrote a letter to the UN marking our formal acceptance of the core six principles. Our membership, in what was then a fledgling organisation, was something that very much resonated with Rathbones given our history and culture, and was something we very much wanted to be involved with.

When we signed up, Rathbones had around £10bn in assets under management, compared to close to £50bn today. Our membership was spearheaded by Rathbone Greenbank Investments, a team that has more than 20 years' experience in delivering specialist ethical and sustainable investment portfolios.

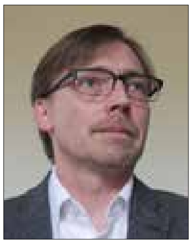
The decision to sign up to the PRI was a strategic one, supported by the wider organisation, to align with the principles and commit to building on our existing approach. The most important step was recognising that governance and other non-financial risks can be material factors in the determination of investment risk and return outcomes for our clients.

Today, we are committed to progressing the responsible investment agenda, interpreting this in the context of individual client objectives and needs, and ensuring that we adapt our approach to new information as increased disclosure on ESG factors becomes available.

Establishing new best practice with the 'ESG investing Olympics'

A trio of charities are calling for asset managers to put their money where their mouth is and impress them with their ESG credentials, says Colin Baines.

"THE PURPOSE OF INVESTMENT SHOULD BE TO DIRECT CAPITAL TO SOCIALLY AND ENVIRONMENTALLY USEFUL ACTIVITY"



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

FRIENDS PROVIDENT Foundation, Joffe Trust and Blagrave Trust have come together to invite investment managers to make proposals for an investment mandate of £33.5m.

In what we think to be a first, we took the unusual approach of making this tender public with the key instruction simply to "impress us" on social and environmental integration and impact. The response blew us away, with huge interest from asset managers and asset owners alike.

From the 59 proposals we received, a shortlist of five managers were invited to present at the Royal Institution to an audience of asset owners who share our desire to create impact through their investments.

We were looking for intentional social and environmental impact, high standards of ESG integration covering stock selection and exclusion, engagement and its escalation, voting record, in-house expertise and impact reporting.

WHY TAKE THIS APPROACH?

The three charities have very different charitable objectives: Friends Provident Foundation seeks a fair and sustainable economy that serves people and planet; Joffe Trust's mission is to realise human rights and reduce poverty in developing countries; and Blagrave Trust provides funding to bring lasting change to the lives of young people facing challenge. But we all believe that the purpose of investment should be to direct capital to socially and environmentally useful activity, to create social as well as economic value, and to help address societal challenges.

By running the "ESG investing Olympics", we hope to:

- Bring investment management out of the shadows;
- Draw on the expertise of like-minded investors and grant recipients;
- Share learning on emerging best practice in the market across different investment approaches; and
- Send a market signal regarding asset owner demand for investment with purpose and expectations for social and environmental integration and impact.

> "We are looking to establish what best practice looks like"

The three charities also have differing financial income/liquidity needs from this investment mandate. We hope to find an investment manager that can maximise social and environmental return on investment, whilst maintaining a reasonable financial return and accessibility for a wide variety of asset owners. In doing this, we hope to find an investment model that has the potential for scalability and systemic impact on how investment markets operate. At the very least, we are looking to establish what best practice looks like across the different ESG and impact investment approaches.

There is growing demand from asset owners to have a purpose beyond financial return with their investments. This is reflected by the exponential growth in funds labelled as impact, sustainable, responsible, green or ESG. However, the quality of these funds varies greatly with marketing claims not always aligned with investment practice.

The sector already attracts criticism for poor standards of integration, engagement and in-house expertise. For example, last year UKSIF found that 86 per cent of fund managers claimed they were engaging companies to align their business with the Paris climate agreement, but more than half had no plan if the companies did not respond or meet their demands. Asset managers really should be producing clear policy around escalation of engagement and how this might happen, eg voting against board elections, tabling shareholder resolutions, and ultimately divestment, plus reporting on implementation.

DIVEST, INVEST, TRANSFORM

We are seeking an investment manager supportive of our objectives and compliant with Friends Provident Foundation's new, challenging, investment principles and policy, as well as our climate emergency declaration (or is willing to actively work with us to comply); as indicative of the standards expected by all three charities.

Friends Provident Foundation believes that our decisions on what to invest in, what not to invest in, how we exercise our stewardship responsibilities as a shareholder, and how we engage with the financial system as a whole in our capacity as an asset owner should contribute to our objective of a sustainable and fair economy.

Last summer, Friends Provident Foundation also declared a climate emergency, recognising that business as usual risks climate breakdown with profound consequences for people and planet; and viewing the prevention of runaway climate change as an eco-socio-economic challenge and prerequisite to achieving our objective.

Too much time has been spent on the fossil fuel divestment versus engagement debate; those that have divested or are undertaking meaningful and forceful stewardship are on the same side and doing more than the vast majority. There is not a single magic bullet that will bring the rapid and far-reaching changes needed in energy, land use, transport, buildings, industry, and the financial system itself. We need comprehensive policy with high standards of exclusion, ESG, impact and engagement all pulling in the same direction.

Our investment policy and climate emergency declaration states we will not invest in companies involved in the following areas:

- Extraction, production and distribution of fossil fuels, and similarly high carbon fuels.
- Unsustainable harvest of natural resources.
- Intensive farming methods that degrade the environment.

And we will use our influence as a shareholder to:

- Promote a just and net-zero carbon transition, calling for the adoption of business models that are consistent with keeping global heating below 1.5°C and ensure economic shocks to workers, communities and consumers are mitigated.
- Promote responsible corporate lobbying, calling for disclosure of direct and indirect public policy intervention, and to align lobbying (including via intermediaries such as trade associations) with company social and environmental commitments.

In addition, we will particularly favour investments in:

- Providers of renewable energy generation and storage, energy efficiency and demand management services, and other companies whose business model focus is on net-zero carbon transition, resource efficiency and circular economy, and environmental sustainability.

Following our climate emergency declaration, we expect our investment managers to:

- Vote for all climate change-related shareholder resolutions (taking a comply-or-explain approach).
- Engage investee companies to publish 1.5°C transition plans and align corporate lobbying.
- Encourage investee companies to align their capital expenditure and remuneration strategies with keeping global heating below 1.5°C.
- Adopt a shareholder engagement escalation policy, eg will vote against director re-elections or file shareholder resolutions if company responses are inadequate.

> “Social is the poor relation...in the ESG market”

WHERE IS THE ‘S’ OF ESG?

It is fair to say that social is the poor relation of environmental and governance in the ESG investment market. Most ESG funds tend to invest in sectors like tech, media, finance, consumer, utilities, manufacturing, and retail. Many of the companies are high risk from the ‘S’ perspective of ESG, but investment manager integration and engagement are less developed.

We are hoping to encourage a step change. Our new, challenging investment policy, which “ESG investing Olympics” entrants are expected to adhere to (or work with us to adhere over time), include excluding companies that:

- Fail to implement basic labour rights (eg freedom from forced labour and freedom to bargain collectively).
- Fail to uphold basic human rights within sphere of influence.
- Engage in bribery, corruption, money laundering and tax evasion.

They are also expected to engage with companies to:

- Promote fair pay – call for all employees to share in the success of companies, supporting the Living Wage, controlling high executive pay and discouraging wide pay disparities. Also, to encourage pay policy transparency and link executive pay to social, environmental and economic sustainability objectives.
- Promote decent work – call for dignity and justice in the workplace, eg employees working regular hours to receive regular contracts, and allowing unions access to the workplace.
- Promote responsible payment of tax – call for tax planning that is transparent and adheres to the spirit and letter of the law, and discourage the use of tax havens and activity with the primary purpose of tax avoidance.

The “ESG investing Olympics” involved five best-in-class investment managers presenting proposals to deliver the highest possible social and environmental impact alongside a financial return. A range of different investment managers and approaches presented, from boutique impact investment managers to multi-trillion pound publicly listed investment banks.

Over 100 attendees attended the Royal Institution, which has a history of public dissection for the benefit of learning and progress. The audience of like-minded asset owners and relevant grant recipients helped us consider the proposals, questioned the investment managers, discussed the trade-offs between different approaches and the merits of different proposals, and helped our trustees to decide which proposal to choose.

Now the “ESG investing Olympics” has taken place, we will analyse the proposals we received to produce a report covering trends, areas of improvement and remaining gaps, and feature the five shortlisted as best-in-sector case studies. We wish to share learning with like-minded asset owners and signal to the market what emerging best practice and asset owner expectations for higher standards of ESG and impact look like. We hope to help set the benchmark for what ratings agency Moody’s called the “next growth frontier for asset managers”. ●

Interview with PAUL ABBERLEY

Chief executive officer – Charles Stanley

The direction of travel for ESG investments is undeniably positive, but there are challenges when it comes to analysis.

Charles Stanley is one of the larger UK wealth managers with almost exclusively UK clients, including high net worth individuals and institutional investors such as charities. Chief executive Paul Abberley took the helm in 2014, building on the success of the firm with a strategic review and a focus on bespoke investment portfolios.

As Environmental, Social and Governance (ESG) factors have come more to the forefront over recent years, this emphasis on detailed conversations around tailored investments has stood the nearly 250-year-old firm in good stead.

> “Responsible investing will become a natural part of the capital markets”

“Our bespoking of client investment portfolios has always included a discussion around any ethical questions they may have,” says Abberley. “This is not new for us. We can build those factors into the investment process. The ability and willingness to incorporate ESG screening predates the more recent growth in interest in this type of investment.”

The veteran asset manager says that the interest in responsible investing has been driven by institutional and professional intermediaries who have been spurred into action by social and regulatory pressures.

He says: “There has always been selective negative screening, especially by charities, but over recent years there has been an increased interest in ensuring the overall portfolio is invested responsibly.”

ESG RISK FACTORS

This shift presents its own peculiar set of challenges. “Although ESG risk factors are things that analysts should have always been looking at, we can question how thoroughly the participants in capital markets have really been analysing these risks,” says Abberley.

“Now that the emphasis has shifted, analysts need to dedicate more time to ESG factors and this can be very labour intensive. Analysis of a balance sheet you can do using Excel and a lot of the data is already public but, when it comes to ESG analysis, it is qualitative and much of the information is not readily available.”

The subjective nature of the analysis is a real

CHARLES STANLEY
Wealth Managers

What we do

Charles Stanley's charity specialists have earned a reputation for meeting the investment needs of charities of all sizes and sectors. By paying attention to the particular priorities, challenges and needs of our clients, we can create an investment strategy and mandate that is bespoke for their unique objectives, rather than slotting them into pre-existing products. Above all, it is the personal relationship between investment manager and charity that sets us apart. We don't use relationship managers so you can be confident that the person you are speaking to is the same investment manager who is looking after the charity's investments.

The value of investments can fall as well as rise. Investors may get back less than invested. Charles Stanley & Co. Limited is authorised and regulated by the Financial Conduct Authority.

FAST FACTS*

- Total charity clients 821
- Total charity funds under management: £1.14bn

*Figures as at 31 December 2019

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problem, he says. "If you are simply interested in the profitability of a company, that is pretty objective but, when you are looking at governance for example, it can be difficult to measure." It is also not generally transferable from company to company. "You cannot read across the numbers as the reporting formats are still in their infancy. Comparing the data from one company with another's is fraught with difficulties."

One of the issues, says Abberley, is that there still remains huge inconsistencies with the ratings provided by independent agencies. "ESG assessments of a company can vary greatly depending on which provider you use."

This presents a challenge for charities that are seeking a more systematic approach, such as a numerical ESG scale, which can be applied to a company's profile.

"Charities obviously are keen to avoid the ESG equivalent of greenwashing but, if the underlying data is unreliable and lacks precision, it is hard to know in all good conscience whether your methods of measuring are truly robust. There is a recognition in the industry that something needs to be done about this but we are some way from coming up with a system or a set of guidelines that can address all the issues around subjectivity."

RULES OF THE GAME

Despite such challenges, responsible investing is here to stay. "Responsible investing will become a very normal and natural part of the capital markets," says Abberley. "Regulations are changing around private client investing and, soon, conversations around ESG requirements will be mandatory. As a result, capital flow will be increasingly invested with ESG, much more than even 10 years ago. The direction of travel is very positive in this respect."

> "Capital flow will be increasingly invested in ESG, much more than even 10 years"

This trend will benefit those institutional investors that are ahead of the curve when it comes to responsible investment.

"Capitalism has always operated within the rules and regulations of the market. But nowadays, there is less tolerance, socially and politically, of companies that behave badly," says Abberley. "If regulations are being set to benefit those companies that are operating responsibly, it is reasonable to assume that return on capital at the margins will continue to improve, and that will be at the expense of companies or industries that are considered less socially responsible. The rules of the game are changing."

The time to act on climate change is now

ALEXANDER TRUE and TANIA MCLUCKIE
Specialist charity managers – Sarasin & Partners

Industry players should adopt a package of measures at the forthcoming climate negotiations COP26.

What is your approach to responsible investment?

Our focus for 2020 is policy outreach centred on climate change in the lead-up to COP26. Climate change poses material risks to our investments, and the scientific evidence shows that the materiality of this risk is growing. We are calling for five market actors to make pledges to align their activities with the Paris climate agreement.

1. Accounting standard setter (IASB): to ensure accounting standards make clear where capital is at risk as we transition to net zero.
2. Auditors: to call out where accounting risks exist in alignment with the Paris accord.
3. Proxy voting advisory firms (ISS and Glass Lewis): to ensure they are not supporting directors that are pursuing strategies that run contrary to the Paris goals.
4. Large asset managers: to vote only for directors that have confirmed Paris alignment.
5. Credit rating agencies (S&P, Fitch and Moody): to incorporate climate risks in credit ratings.

We are promoting this as a package of measures at the forthcoming climate negotiations in Glasgow in November (COP26). The aim is not to draw attention away from the imperative for governments to act, eg through a global carbon tax, but to offer some practical actions that we can move forward with and, in so doing, help increase the momentum for political action.

> “Climate change poses material risks to our investments”

How can charities align with the Paris Climate Accord?

Charities should mandate their investment managers to identify companies that are aligning themselves with the Paris goals. In our Climate Pledge, published in January 2019, we made a public commitment to align our business with the Paris goals. Through our stewardship, we will ensure that the companies our clients invest in are Paris-aligned by:

- Proactive engagement – We initiate and support dialogue with boards for companies to publish Paris-aligned strategies, including measurable mid-term targets.
- Voting – We oppose director appointments where individuals are blocking the implementation of a Paris-aligned strategy and vote against auditors where we believe the annual report and accounts fail to report material climate risks.
- Divestment – We sell a company’s shares where we believe our clients’ capital is at risk and leadership is failing to respond appropriately.

We also commit to promote policy reforms through:

- Policy outreach – We engage with regulators and policy makers wherever we believe we can accelerate or improve action to combat climate change.
- Public statements – We speak out publicly, and build/support coalitions of like-minded investors and thought leaders to drive change where we believe this will be effective.

What we do

Sarasin & Partners LLP is a London-based asset manager that manages £14.7bn on behalf of charities, institutions, intermediaries, pension funds and private clients from the UK and around the world. Consistent with a longer-term approach is a commitment to stewardship principles, embedding environmental, social and governance considerations into the heart of the investment process.

SARASIN & PARTNERS

FAST FACTS*

- Sarasin manages £7bn for 440 charity and not-for-profit clients
- Charities represent nearly 50 per cent of total business
- Climate Active Endowments Strategy has been adopted by over £550m of charity assets, £250m reside in the Sarasin Climate Active Endowment CAIF

*All figures as at 31 December 2019

How do you see stewardship evolving?

Effective stewardship is resource intensive and by no means begins and ends with climate issues. As stewardship principles are adopted and embedded within investment analysis, we would hope to see an increase in thoughtful voting and engagement across all types of shareholders. The costs will have to be borne by asset owners, even where their savings are managed passively.

Asset managers have an incentive to limit authentic stewardship activities in favour of cheaper, but token, oversight. This may occur even where the benefits of stewardship to the ultimate owners far outweigh the costs. This poses a critical challenge for the investment industry: how to cement responsible long-term investing and stewardship as an enduring reality rather than a transitory phase.

One of the three aims of the 2015 Paris Agreement was a commitment to make financial flows consistent with achieving a pathway towards low greenhouse emissions and climate-resilient development. This is as crucial as the other two aims (to limit the global average temperature rise and to increase the ability to adapt to climate change) but not as well understood. We are likely to see an increase in initiatives such as the Task Force on Climate-related Financial Disclosures (TCFD) as well as a response from policymakers and regulators calling for more action related to financial flows.

> “The rise of greenwashing highlights the need for standardisation”

How can charities identify effective stewardship?

With attention on Environmental, Social and Governance (ESG) increasing, there has been a proliferation of funds and strategies that claim to focus on these issues. But there is a danger of “greenwashing”. The rise of this “greenwashing” highlights the need for standardisation and verification, allowing investors to understand clearly the ESG credentials of their investment. Here are some things to look out for when assessing a fund manager:

- Is the fund manager a signatory to the UN PRI?
- Do they integrate ESG into fundamental analysis? How do they evidence this? Are ESG factors incorporated into stock notes and valuation models?
- Can they provide examples of where ESG factors led to buy or sell decisions?
- Have they published a UK Stewardship Code Statement, with details on how it is being implemented?
- Can the fund manager evidence that they use voting actively across all their assets to encourage improvement in corporate behaviour?
- How often do they vote against management?
- Does the fund manager publish all their votes regularly (at least semi-annually)?
- Does the fund manager conduct active discussions with company management teams, and report on the impacts of these engagements?

How can charities unlock the power of their money?

Charities are well placed to help shape a more sustainable economy so long as they take the right steps to adopt responsible investment, says Lisa Stonestreet.

"THERE IS NO ONE-SIZE-FITS-ALL APPROACH TO RESPONSIBLE INVESTMENT BUT THERE IS A PROCESS"

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

BARONESS TINA Stowell, the current chair of the Charity Commission, spoke last year at a Charity Leadership Forum event of the increasingly complex role of many individual charities amidst a challenging background of political turmoil, economic uncertainty and record levels of public mistrust in the sector. She argued that in order to maximize their benefit to society and inspire public trust, charities must behave more ethically and "live their values". In the context of a charity's investment and financial decisions, this could potentially feel like yet another weight on its shoulders. And yet, responsible investment and the opportunity for change that it presents can alternatively be seen not as a burden, but as a powerful tool.

The EIRIS Foundation strongly believes that charities have an influential and exciting role to play in shaping a more sustainable financial system. By ensuring they are investing and saving responsibly and in harmony with their mission and values, charities can reap significant mission-related, reputational and financial benefits while complementing the voluntary sector's fundamental objective of building a fairer society and achieving the UN Sustainable Development Goals (SDGs). Financing is obviously a key aspect of delivering the SDGs. It is estimated that there is a \$2.5tn annual investment gap that needs to be filled in order for this to happen.

The UK charity sector's investment assets are collectively worth £102.3bn (Source: *NCVO's UK Civil Society Almanac*). The power of these assets if invested responsibly is significant, but exponentially more powerful is the potential for charities to use these assets and their voice to shift all UK assets towards financing the move to a more sustainable economy and world.

> "Charities have an influential and exciting role to play"

Incorporating environmental, social and governance factors and other values into investment decisions has never had more attention. Rapid growth and developments in this space have been the norm over the past 12 months and look set to continue. Divestment from fossil fuels is a big part of the conversation, and many large institutions, from foundations to universities to local authorities, are considering how climate change should affect their investment policies. In October 2019, new regulations came into force clarifying and strengthening pension scheme trustees' environmental, social and governance responsibilities.

REGULATORY DEVELOPMENTS

Currently it is not a regulatory requirement for charities to invest sustainably or responsibly. However, in line with other investors and wider society, there is increasing interest in this issue. In March last year a coalition of charities (which the EIRIS Foundation has joined) called on the Charity Commission and Attorney General to seek a landmark ruling on whether and how charities should align their investments with their objects and their duty to provide public benefit. The coalition has argued that existing guidance is outdated. In addition, the Charity Commission is currently seeking views on how charities approach investing in line with their purpose and values. In seeking these views, they have acknowledged that "it is increasingly prudent for trustees to consider the factors affecting the longer-term financial sustainability of their investments."

Although there are a number of charities that have been, and continue to be, pioneers in responsible and sustainable investment, there are still charities of all sizes who have no, or incredibly basic, responsible investment policies and practices. There is no one-size-fits-all approach to responsible investment but there is a process for all charities to go through in determining what is right for their own organisation.

Whether a charity is considering responsible investment for the first time or revising their current policy in line with current best practice or industry developments, there are a number of broad steps that it is advisable to follow. These are:

1. Gathering information
2. Agreeing to move forward
3. Developing a policy
4. Implementing the policy
5. Report and review

Setting out your charity's overall values and objectives is a good starting point in a discussion around responsible investment, as the p58 ▸

Interview with KELLY TRAN

Client director, commercial sustainability lead – Newton Investment Management

Given the severity and urgency of the climate crisis, is it time that charities divested all investment in fossil fuel companies?

Over the last six years, Newton Investment Management has carried out a survey of charities to gain insight into investment practices. Last year's survey garnered responses from 102 charities with a combined investment pool of around £14bn. The responses showed a rise in concerns among charity trustees and decision makers about climate change and sustainability when it came to their investment portfolios.

> “ More charities are adopting fossil fuel exclusion policies ”

“Over the last 12-18 months, climate change has come up constantly in meetings with clients,” says client director and commercial sustainability lead at Newton Investment Management, Kelly Tran. “They want to know how we can take into account climate change in their portfolios at a holistic level.”

These observations are reflected in the 2019 survey. A total of 64 per cent of charities said that they felt that it was their responsibility to think about climate change, with around a third coming under pressure from stakeholders to consider this in their investment strategies. “This pressure has started to effect real change,” says Tran. “More charities are adopting fossil fuel exclusion policies.”

Again, this is reflected in the survey. In the 2016 poll, around 25 per cent of respondents said they will or have excluded fossil fuel investments; by 2019, this stood at a third. “Significantly, 48 per cent of those charities that have debated this topic, but, as yet, have taken no action, also said that they would revisit the decision this year. I think a lot of those charities will decide on a course of action on climate change and that may mean stopping all investment in the fossil fuel industry, or taking other approaches that will signal to the industry that investors want to accelerate the transition towards a lower-carbon world.”

EVOLVING CAPITALISM

Tran says that during her conversations with charity clients, it is becoming clear that more and more asset owners want to take an active part in the stewardship of their investments and not rely solely on their fund managers. “It seems they are striving for a collective voice, particularly when it comes to engagement with climate change,” she says. “Our clients are demanding more results and action, not just words and promises.”

They are also looking to develop a common

What we do

Newton Investment Management is a global asset manager, providing focused investment strategies to clients around the world. A BNY Mellon company, we use bottom-up security selection tied with a thematic framework to create and manage strategies that aim to help secure our clients' futures.

In addition to financial measures, we evaluate factors such as environmental impacts, social standards and the effectiveness of people in charge. We believe this "purposeful ownership" approach allows us to better manage risk and make more informed investment decisions.

NEWTON
Investment Management

FAST FACTS*

- Managing £49.8bn of assets
- Clients include pension funds, corporations, charities and, via BNY Mellon, individuals
- Four decades of global investment experience, with particular expertise in absolute-return, income-focused, high-conviction and sustainable investing
- ESG analysis fully integrated into our core investment process

*Figures as at 31 December 2019

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language when it comes to the climate crisis and wider efforts to tackle climate change.

"Clients are asking about the carbon footprints of their portfolios. They no longer focus simply on the risk and return profile," continues Tran. "There is a change from a shareholder capitalism to a stakeholder-focused capitalism. Clients want transparency and are looking at their investment portfolio through a different lens. Previously, the focus would be on financial metrics alone, but charities now want to align their portfolios with the core values of their organisation."

PROS AND CONS

But is divesting all investment in fossil fuels the right course of action? According to the 2019 survey, 24 per cent of respondents felt that divestment was the best way to tackle the climate crisis, but the vast majority (70 per cent) think that engaging with companies is the best method.

Tran suggests there are pros and cons to stopping all investment in fossil fuels. "If you take fossil fuels out of the portfolio, that puts public pressure on the companies and immediately divests capital – it is tangible, raises awareness and reduces the carbon footprint," she says. "But it also excludes fossil fuel companies that are transitioning towards greener energy, for example. The question is whether divestment is better than lobbying behind closed doors."

Another point to consider, says Tran, is that the secondary market will continue to invest regardless, perhaps with less concern about the environmental or social impact. "Does simply excluding fossil fuel companies capture the nuances of the global energy market or solve the problems we are facing?"

> "Does simply excluding fossil fuel companies solve the problems we are facing?"

Tran also cautions that screening for exclusion may reduce investment opportunities. "You have to think about where else you can invest divested money. Fossil fuels are used in a huge range of everyday products – medicines, fabrics, plastics – it is a much more complex divestment discussion than excluding tobacco, for example."

She adds that trustees should ask themselves a set of questions when discussing fossil fuel exclusion: "First, why are you doing it? And how would you measure success? On what time frame? When should you do it? Who is accountable? Are there any alternatives to divestment?"

No one has all the answers, says Tran. "The challenge is immense but investing with a focus on sustainability is the right thing to do."

process is ultimately about linking your charity's values with its investments. These values will be clear for most charities and be based upon your mission statement.

Your charity should already have agreed the financial objectives of your investment policy – for example, income levels and capital growth, acceptable levels of risk and asset allocation. These factors will influence how social, environmental or ethical considerations can be incorporated into your charity's investment strategy.

Your charity should also try to define its reasons for adopting responsible investment. These objectives, for example avoiding risk to your reputation or particularly wanting to make mission-related investments, will help you to decide on the issues and approaches to implement.

The list of potential issues and/or impacts to consider can seem long. But as the range of options available in the market has widened, so too have the approaches and range of social, environmental and ethical issues that it is possible to incorporate. Your fund manager or investment adviser may be able to provide you with a list and sometimes these will be grouped in a thematic way. Your charity may wish to consult with its stakeholders (for example, staff, beneficiaries and supporters). This can be done on a formal or informal basis.

It is useful to consider which issues are of most importance to your charity and if any are "negotiable". For example, if you would be willing to invest in the best performing companies within a particular sector rather than excluding the whole sector.

This will help you to decide on the approach to apply to your investments (negative screening, positive screening or engagement, investing to maximise social impact), and in the case of negative screening, whether you wish to set a materiality level on turnover – for example, avoiding companies that derive more than 10 per cent of turnover from the sale of tobacco products rather than any company selling tobacco.

Research can show how the companies that your charity currently invests in would be affected if you applied screens on particular criteria. Research providers or your fund manager may provide such information and help you understand how setting levels of materiality or specific criteria could impact on your investable universe.

When talking to charity employees and trustees about their relationship with their investment managers and/or other financial advisers or consultants, it is clear to me that not enough of them feel completely confident when it comes to asking challenging questions. Especially now that ESG and responsible investment is becoming more mainstream, there are organisations whose claims of expertise in this area don't necessarily stack up. As the clients, as the custodians of charity funds and as the people in positions of power and responsibility, it is vital to ask questions. If you don't understand the answers, ask again, ask for clarity and ask for things to be explained in a jargon-free way.

> "It is useful to consider which issues are of most importance"

WHAT TO ASK

A good starting point is to ensure that your providers are clear about how they define various terms such as what ethical, sustainable, responsible and impact investing mean to them. Other things to consider when questioning providers include:

- What is their approach to research and screening of their investments? Do they use external research providers, or do they have in-house expertise?
- How do they ensure continued compliance with any criteria?
- How have the ESG criteria impacted on the portfolio? Can they provide examples of where this has led to the decision not to invest in a company?
- If they vote responsibly, is it on all holdings or only those marked as "ethical"?
- What is their engagement approach? Can they provide you with good examples of engagement successes?
- How and what will they report to you? Does it include responsible investment case studies?
- Do they provide any impact reporting? This could include the carbon footprint of their portfolios.

Responsible investment has sometimes been considered an issue for only the larger charities, those with considerable amounts of investable capital. However, increasingly charities of all sizes have begun to think of how their choice of all financial providers can be aligned with their charitable objectives and values. The EIRIS Foundation has recently developed the *Charity Ethical Money Action Plan* to help charities do this.

The Action Plan focuses on four key areas for charities to consider:

Portfolio & products – Do you consider ethical, environmental and social factors when choosing where your money is invested and/or saved?

Pension– Have you incorporated your organisation's values and mission-related considerations into your choice of employee pension fund/s?

People – Do you use your voice to help others, particularly your employees and supporters/members, to understand that their finances can have a positive impact on society and the environment?

Partnerships – Do your partnerships, both with corporates and others, align with your values and ethics and help to further your overall mission and charitable purpose? Charities, by their very nature, exist for public benefit. Trustees, employees and other stakeholders are increasingly aware of the disconnect between a charity working to eradicate social and environmental problems while elsewhere the charity's money, which could be part of the solution, is perhaps funding activities or companies which are part of the problem.

I urge charities to use their have considerable power to be part of the transition to a sustainable economy. ●

Many thanks to all the contributors. For more details of our Responsible Investment Conference please visit *https://bit.ly/2TLcGOu*

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