Responsible Investment

Published by Civil Society Media

May 2023
www.civilsociety.co.uk

Making a real change with your investments

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

CharityFinance
SUPPLEMENT

The responsible investment landscape continues to evolve

The Butler-Sloss case has dominated discussion, but it is not the only development in responsible investment for charities, says Tristan Blythe

"TRUSTEES NEED TO BE CAREFUL IN RELATION TO MAKING DECISIONS AS TO INVESTMENTS ON PURELY MORAL GROUNDS"

Tristan Blythe *is editor of Charity Finance*

IN TERMS of responsible investment and charities, one discussion point has dominated over the past year – the High Court decision in the Butler-Sloss case.

The background to the case was that two charitable trusts, the Ashden Trust (now called the Aurora Trust) and the Mark Leonard Trust, had sought judicial approval of their investment policies which were based on scientific evidence of climate change and excluded, as far as practically possible, investments not aligned with the goals of the Paris Agreement.

The two trusts felt the need to take this action as they believed the previous case on charities' rights around ethical investment, commonly known as the Bishop of Oxford case, was outdated. This case took place in 1992 and involved the Bishop of Oxford challenging the Church Commissioners for England over its investment policy. The bishop argued that the Church Commissioners should apply an ethical filter to its investments in order to ensure they aligned with Christian beliefs and values.

The outcome of this case recognised that there were times when a charity may wish to pursue an ethical approach to its investments, but stated that this was a secondary consideration to maximising investment income.

A GREEN LIGHT FOR GREEN INVESTMENTS

In the Butler-Sloss judgment, which was handed down at the end of April 2022, Mr Justice Michael Green approved the proposed Paris Agreement-aligned investment policies.

"The claimants have decided, reasonably in my view, that there needs to be a dramatic shift in investment policies in order to have any appreciable effect on greenhouse gas emissions and for there to be any chance of ensuring that there is no more than a 1.5°C rise in pre-industrial temperature," the judgment says.

Therefore, Mr Justice Green says the trustees had "exercised their powers of investment properly and lawfully".

> " The trustees need to exercise good judgement "

"Where there are difficult decisions to be made involving potential conflicts or reputational damage, the trustees need to exercise good judgement by balancing all relevant factors in particular the extent of the potential conflict against the risk of financial detriment," he adds. "If that balancing exercise is properly done and a reasonable and proportionate investment policy is thereby adopted, the trustees have complied with their legal duties in such respect and cannot be criticised, even if the court or other trustees might have come to a different conclusion."

He also notes: "Both the Charity Commission and the Attorney General submit that the claimants did not adequately balance the potential financial detriment that would be suffered by the adoption of the proposed investment policy with the conflict to the charitable purposes.

"However it is clear from the proposed investment policy itself that there is a targeted rate of financial return within it, which the Charity Commission's evidence indicates is in line with the published rates of return of other large charities, such as the Church Commissioners or the Wellcome Trust."

It is important to note that the two trusts were focused on environmental work, and therefore were seeking to exclude investments which, they argued, directly conflicted with their charitable aims. But the judgment warns against using a purely moral approach to exclusion.

"However, trustees need to be careful in relation to making decisions as to investments on purely moral grounds, recognising that among the charity's supporters and beneficiaries there may be differing legitimate moral views on certain issues," it says.

POSSIBLE LEGAL ACTION

Prior to the judgment, the Charity Commission had carried out a consultation on its guidance covering responsible investment and was in the process of updating this guidance. It put the process on hold until the outcome of the judgment was known.

We now know a little bit more about what will be in the guidance. And, in November 2022, when the Commission first published an update which said the new guidance should be available by the summer

of 2023, it comments attracted criticism from lawyers.

This was because the Commission said that it did not believe that the judgment fundamentally changed the legal principles on the issues. "We consider that the judgment offers welcome clarification of how existing legal principles should be interpreted by trustees in a modern context, but that it does not fundamentally alter those principles," its update says. "We therefore confirm that charities can continue to rely on the legal position in our published guidance Charities and Investment Matters: A Guide for Trustees (CC14) when making investment decisions.

"The judgment also confirms that there is no obligation on trustees to do so – they can, where appropriate, make financial investments designed only to secure the best financial return. Indeed, the principles which apply to wider cases were set out by Mr Justice Green, and he stated these as: 'Charity trustees' primary and overarching duty is to further the purposes of the trust. The power to invest must therefore be exercised to further the charitable purposes. That is normally achieved by maximising the financial returns on the investments that are made'." ▶ p32

The financial regulator attempts to clamp down on greenwashing

Some charities remain concerned about the possibility of so-called "greenwashing", the exaggeration or fabrication of sustainable investment practices by investment management funds.

While there are undoubtedly genuinely responsible investment approaches at reputable investment management firms, the Financial Conduct Authority (FCA), the regulator of the financial services sector, has recently taken a number of steps to increase its oversight of this area in order to do away with greenwashing and provide reassurance to investors.

In October 2022, it opened a consultation into proposals designed to clamp down on greenwashing. It suggested introducing:

- Sustainable investment product labels that will give consumers the confidence to choose the right products for them. There will be three categories – including one for products improving their sustainability over time – underpinned by objective criteria.
- Restrictions on how certain sustainability-related terms – such as "ESG", "green" or "sustainable" – can be used in product names and marketing for products which don't qualify for the sustainable investment labels. It is also proposing a more general anti-greenwashing rule covering all regulated firms. This will help avoid misleading marketing of products.
- Consumer-facing disclosures to help consumers understand the key sustainability-related features of an investment product – this includes disclosing investments that a consumer may not expect to be held in the product.
- More detailed disclosures, suitable for institutional investors or retail investors that want to know more.
- Requirements for distributors of products, such as investment platforms, to ensure that the labels and consumer-facing disclosures are accessible and clear to consumers.

The consultation closed in January and the final rules are due to be published by the end of September 2023.

An important element of avoiding greenwashing is the use of data to hold fund managers to account. One way that some investors do this is to use benchmark providers – another area that has come under FCA scrutiny.

In March, it published the results of its review of ESG benchmarks. It identified a number of issues, such as:

- Not enough detail on the ESG factors considered in benchmark methodologies.
- Not ensuring that the underlying methodologies for ESG data and ratings products used in benchmarks are accessible, clearly presented and explained to users.
- Not fully implementing ESG disclosure requirements.
- Benchmark administrators failing to implement their ESG benchmarks' methodologies correctly – for example, using outdated data and ratings or failing to apply ESG exclusion criteria.

In a statement, the FCA said: "We have previously said that we support regulation of ESG ratings."

In March, the government launched a consultation on whether to extend the FCA's remit to include these ratings providers. It will run until 30 June 2023. The consultation paper can be found at https://bit.ly/40wgfrM. Comments can submitted by emailing ESGRatingsConsultation@hmtreasury.gov.uk.

As well as attempting to improve standards and reduce greenwashing, the FCA has taken some steps in order to help it meet its ESG-related responsibilities. This includes meeting the government's expectation that it has regard to the UK's commitment to achieving a net zero economy by 2050, when considering how to advance and achieve its objectives and functions.

For example, it has created an ESG advisory committee, which includes Catherine Howarth, chief executive of ShareAction, a charity which promotes responsible investment via shareholder action.

It has also published a discussion paper, entitled Finance for Positive Sustainable Change: Governance, Incentives and Competence in Regulated Firms, and called for responses to it. The paper is designed to help the FCA to support the finance industry in playing a role in the transition to net zero and generally to become sustainable, as well as to inform its future regulatory approach. Interested parties only have until 10 May to submit responses – https://bit.ly/3KhAP9G.

INTERVIEW BARCLAYS PRIVATE BANK

Building momentum with ESG investing

An interview with

IAN CHESHAM

Director, Charities Team – Barclays Private Bank

Over the last few years, the environmental, social and governance (ESG) responsible investing environment has seen rapid change. And as 2023 gathers pace this year is proving to be no different. "It is exciting because responsible investment is constantly moving forward," says Ian Chesham, Director of the Charities Team at Barclays Private Bank. "There's always new solutions. It is such a positive area and it has a lot of momentum."

This year, Chesham says that he is seeing an increased focus on optimising cash balances. "And that means looking at things such as fixed-income portfolios.

> "Responsible investment is constantly moving forward"

The challenge and consideration for trustees whether their bond portfolios align to ESG and responsible and sustainable values. Trustees are now grappling on how to decide which products and solutions meet the same ESG criteria that they were used to seeing in the equity market. In reality, there isn't quite as many, but there are more than there used to be."

UNDERSTANDING ESG

Decisions such as these are much better informed, says Chesham, because trustee understanding of ESG investment has greatly improved over recent years. "Four or five years ago, the level of knowledge around ESG among trustees at charities around the UK was minimal," recalls Chesham. "But we have seen trustees taking the time to learn about responsible investing and understand it. Everyone's much better informed."

Despite the recent macro and micro economic challenges, Chesham doesn't think enthusiasm among charities to stick to a responsible investment strategy has waned. "I think charities' focus may have moved away from investments generally, because they've got to prioritise – their resources are being depleted and the need for their services has increased so the focus has been on daily challenges. But the desire to have responsible and sustainable investments has continued."

As part of the trustees becoming better informed and understanding ESG in more detail, they have realised that ESG solutions don't necessarily mean a reduction of returns; in fact they can enhance returns. "The evidence of the last few years has been that ESG strategies – sustainable and responsible strategies – despite a difficult year last year, have outperformed as a whole.

"It would be easy to slip back and want to invest in fossil fuel companies because they have done really well this year. But we are thinking five to 10 years ahead. The outlook is not so rosy for these types of companies because they are going to have to completely transform their businesses and there's a big question mark about whether they can do that. I prefer a company with a future. I think our charity clients understand that."

EVIDENCING IMPACT

To further understanding, Barclays publishes an annual sustainability report on the Barclays Private Bank website (new report out in April 2023), which gives charities the evidence of what companies have done to meet UN sustainable development goals.

FAST FACTS

- Over 65 years' experience working with charities across the UK
- Barclays Private Bank manages in excess of £120bn in client assets
- Barclays group target is to facilitate $1trn of sustainable and transition financing by end of 2030

"Charities can use this to articulate how their investments are having a positive impact, not only a financial one," continues Chesham. "They can show how they use investments, not just to support grantmaking or increase income, but to reflect the whole ethos of the charity. People are realising that the synergy of investments and the messaging and the charity all come together in a really positive way. I think charities are getting wiser in how they can use these portfolios to message what they're doing for the world. So when they are making climate emergency statements, they are using portfolios as evidence to show action they have taken."

> "Trustee understanding of ESG investment has greatly improved over recent years"

For Barclays, this means giving them the evidence to show their stakeholders. Data is a key element to this, especially when it comes to decarbonisation and aligning with the Paris Agreement, adds Chesham. "Data allows you to analyse more about the companies that you have, their impact and their ability to demonstrate that they are Paris aligned; not just to look at the historic emissions of a company, but try to look at the implied temperature rise of the companies in the future based on what they are currently doing and the planned reduction of emissions."

Chesham says that trustees are becoming more questioning about issues such as greenwashing, and that's a good thing. "The key is transparency and being clear in terms of what our client is invested in. The majority of our portfolios are segregated, so you can see the underlying holdings. We have a robust approach to ethical screening, clear and precise monitoring and ESG analysis that goes alongside that. You have to demonstrate that you are doing what you say you are doing. When we created the sustainable strategies, we always wanted to make sure that everything that we do could be evidenced."

NAVIGATING UNCERTAINTY

Chesham believes there are opportunities to stabilise income. "Interest rates have completely transformed the fixed-income asset class. According to Barclays Private Bank Fixed Income Research February 2023, the yields within the UK investment grade market are over 5%, which if you can lock in for the next couple of years is quite compelling. It's behind inflation but that may be back within the 2% range by 2025-26."

Chesham admits however that there is no escaping the fact that charities need to play a smart investment game to navigate the current climate. "Some charities are depleting their reserves because they need to. But most charities are looking at their reserves and asking us how we can help them do more with it. They have to be wise with their choices and have absolute confidence in their asset manager's ability to help them."

WHAT WE DO

Barclays Private Bank offers investment to charities and not-for-profits. Our team of 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, with direct access to your portfolio manager; treasury and short-term cash management; liability-matching investment strategies; credit facilities; and access to private asset opportunities.

This is a marketing communication issued by the Private Bank operating out Barclays Bank PLC ("Barclays"). These materials and the information contained herein is intended to be generic and is not, and under no circumstances should be construed as, the offer or sale of any specific product or services. The information herein is provided for information purposes only and it is made available only in those jurisdictions where Barclays is licensed or allowed by jurisdictional rules to distribute such materials. This is not research nor a product of Barclays Research department. This information is not directed to, nor intended for distribution or use by, any person or entity in any jurisdiction or country where the publication or availability of its content or such distribution or use would be contrary to local law or regulation. Barclays and its affiliates are not responsible for the use or distribution of this information by third parties. Where any of this information has been obtained from third party sources, we believe those sources to be reliable but we do not guarantee the information's accuracy and you should note that it may be incomplete or condensed. The information herein does not constitute advice nor a recommendation and should not be relied upon as such. Barclays does not accept any liability for any direct or consequential loss arising from any use of the information hereto. © Barclays. Please see www.barclays.com for more information on Barclays worldwide. Barclays offers private and overseas banking, credit and investment solutions to its clients through Barclays Bank PLC and its subsidiary companies. Barclays Bank PLC is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority (Financial Services Register No.122702) and is a member of the London Stock Exchange and Aquis. Registered in England. Registered No. 1026167. Registered Office: 1 Churchill Place, London E14 5HP. †https://secure.charityfinancials.com/library/?pitem=charity-financials-banking-spotlight-report-2020

Is salt or sugar an unwanted additional S in your ESG plans?

One social issue that some charities may want to address in their responsible investment approach is public health. One important element of this is a healthy diet and in recent research from two charities, some of the largest food companies' "flagship" products were found wanting.

The companies covered in the snapshot study (the results of which were released in July 2022) were Danone, Kellogg's, Kraft Heinz, Nestlé, and Unilever.

Action on Salt, which seeks to bring about a reduction in salt intake, and ShareAction, which promotes responsible investment through shareholder engagement, found that over half of UK "flagship" products surveyed from the five major global food companies are "unhealthy", meaning they contain a high level of fat, salt and/or sugar (HFSS). That said, the research also shows that there are differences between companies.

It also found that over a third of the "unhealthy" products surveyed display misleading nutrition and health-based "health halo" claims as part of their product description, while one in three products surveyed that are taking part in the Department of Health's salt reduction programme failed to meet their targets. Unilever was found to be lagging furthest behind.

Nearly two-thirds of Kellogg's and Unilever's "flagship" products surveyed were deemed "unhealthy". Danone has the lowest proportion of "flagship" products which score as less healthy (just two in 20).

In response to the findings, Kellogg's said the products covered were not its "top selling products" and that the findings were not "representative of our full product range". It added that: "Four out of five of Kellogg's top-selling cereals are non-HFSS and by next year all of our children's cereals will be non-HFSS."

Ignacio Vazquez, head of health at ShareAction, said: "While some manufacturers are taking steps to increase their sales of healthy foods, the overall picture is of an industry lagging behind. The impact of obesity on a healthier society is clear and investments in companies over-reliant on the sales of unhealthy foods are fast becoming stranded assets. We have seen the UK retail market respond to these issues by setting clear targets to increase their sales of healthy foods over time. Shareholders of food manufacturers need to call on them to do the same."

This response has met with some disappointment and suggestions of further legal action.

Law firm Bates Wells wrote to the Commission on behalf of the two trusts and warned that it felt that the update is "inaccurate and, in our view unlawful and vulnerable to challenge by way of judicial review".

"The update appears to be an invitation to trustees to wilfully, recklessly or negligently disregard their obligations and the steps and process described in the Butler-Sloss case," the letter says. "We understand that certain investment managers are now briefing their charity clients to say that 'there is no obligation' upon trustees to invest responsibly."

The letter also states: "We hope the redesigned CC14 not only supports compliance by trustees with their duties as set out in the Butler-Sloss principles but, unlike the update, also encourages best practice when it comes to taking a responsible approach to investment. This would be consistent with the Charity Commission's statutory objective to increase trust and confidence in charities."

In a separate move, the Good Law Project (GLP), a not-for-profit campaign organisation which says it "uses the law for a better world", also wrote to the Commission criticising its guidance on the issue.

> “It risks making judicial review of its guidance a real possibility”

GLP, which is supported by the Royal Society for the Protection of Birds (RSPB) in this matter, writes: "The Commission would appear to suggest that the trustees' discretion is whether or not to consider reasonably identifiable conflicts at all, and may choose simply to ignore them in favour of maximising financial return. But this is not correct. Where a potential conflict between an investment (or a class of investments) and the charitable purposes is reasonably apparent to trustees, then they must consider whether to exclude such investments, exercising their discretion in a manner consistent with the judgment. If trustees could simply ignore or turn a blind eye to potential conflicts it would make a mockery of their overriding duty to further the purposes of the trust: cancer charities could invest in tobacco stocks, Quaker charities in armaments and environmental charities in fossil fuel companies without a further thought."

Like Bates Wells, the GLP and RSPB letter says it "hopes that the Commission's updated guidance will properly and clearly reflect the now established law in this area", but warns that if it fails to do so then they will have "no choice but to consider formal pre-action correspondence".

Last month, the Commission announced that it was "road-testing" the new version with "a representative sample of around 1,000 charities that have investment income, so whose trustees invest charitable funds or assets, and therefore need to use and understand our guidance. We have also shared the draft guidance with some charity lawyers and a limited number of other groups who represent the interests of charities with investments."

In a blog announcing this (https://bit.ly/41Iz6A7), the Commission also revealed that it was retiring the terms "ethical" and "responsible" investment from the guidance. This is because "during a previous consultation charities gave us feedback that these terms were not as clear and inclusive as they could be".

"The new draft guidance instead emphasises that trustees must ensure that, ultimately, the investment approach operates for the benefit of their charity once they have considered all relevant matters. In the context of financial investments, this may lead them to choose to exclude certain investments due to non-financial considerations, or to solely focus on financial return that maximises investment income to spend on their charity's purpose," the blog says.

However, it also adds that while the Butler-Sloss judgment "confirmed that trustees have wide discretion in making investment decisions, for example, in deciding to exclude certain investments based on non-financial considerations", the Commission also says that the judgment "confirms trustees can equally choose to focus just on financial return – ultimately what is appropriate for charities may differ".

It says the updated guidance reflects the judgment. At the time, of writing it is not known if those that had written letters of concern take the same view.

ALREADY ON THE ROAD

Time will tell whether the Commission's guidance will face further legal action and judicial scrutiny, and while there will be some charities reluctant to take action on responsible investment until this is finally settled, already a great number have adopted a responsible investment strategy.

For example, the National Trust recently provided an update on its divestment from fossil fuels, saying it had almost completed the process.

In January, Hilary McGrady told Civil Society News (Charity Finance's sister online daily news service) that the National Trust has reduced its fossil fuel holdings by 98% since announcing plans in 2019 to completely disinvest.

Fossil fuel investments now represent around 0.1% of its more-than £1bn portfolio, but the charity is unable to sell them currently as they are held in private and illiquid investments.

As a result, the charity missed its target to completely disinvest by 2022 but it plans to sell the remaining fossil fuel investments "at the earliest opportunity".

Peter Vermeulen, chief financial officer at the National Trust, said: "All listed fossil fuel investments have been sold out of. In several instances, it has resulted in a new ex-fossil fuel investment having been created that allows other investors to take the same steps."

He pointed out that there is no public market to trade private and illiquid investments on, "so we need to wait for the investments to mature".

"Steps were taken in 2020 to stop any new commitments of this kind to illiquid holdings," he added.

Another charity that has advanced its responsible investment plans is Wellcome. In its 2022 annual report it gave an update on its net-zero investment commitment.

It states that "carbon footprint associated with our portfolio has fallen 35% over the past year". However, this is not solely due to its push towards net-zero, Wellcome admits.

"This year-on-year decline is largely due to our exits from holdings in BP and Shell, which we sold as part of a strategy of reducing exposure to cyclical

▸ p36

Tell us where you need to go.
We'll help you get there.

Investment management for charities, from charity specialists.

The route to a secure financial future can be difficult to navigate. At Rathbones we understand this. We work with charities on an individual basis, taking the time to identify the best strategies for your investment journey.

For further information, please contact Natalie Yapp on 020 7399 0128 or email natalie.yapp@rathbones.com

Rathbones

rathbones.com
@RathbonesGroup
Rathbones Group Plc
@Rathbonesplc

The value of investments and income arising from them may fall as well as rise and you might get back less than you originally invested.

Rathbones Investment Management Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

INTERVIEW INVESTEC

Fund managers need to offer stability amid uncertainty

An interview with
Nicola Toyer
Head of Charities – Investec

"Everyone thought the pandemic was the worst crisis," says Nicola Toyer, head of charities at Investec. "Now two years later, we are in yet another one and this creates a lot of uncertainty."

Toyer says that the rising cost-of-living, energy prices and the war in Ukraine are key factors in driving the biggest macro challenge for investment at present – inflation. "Clearly 2022 was a challenging environment where you saw multi-asset portfolios dropping on average around 10%. A typical charity investor might have been targeting inflation plus 3-4%, but we had inflation go up by just over 10%. So there is a massive gap in what your expected return should be versus what your investment objective was aiming to achieve. And this has impacted charities in very different ways."

> "No one's making any snap decisions"

To a certain degree, the impact felt by a charity will depend on how long they have been investing, says Toyer. "A charity that has been investing for 10, 20 or 30 years will be able to absorb such inflationary shocks better because it has a bigger buffer in reserves due to the benign inflation environment which we have had for the previous decade.

"But other charities might be asking where they will be in a year, or two years. Is their strategy sustainable? They might be looking at drawdowns and asking what impact that will have on reserves and investment pots."

STEADY AND STABLE

But despite the uncertainty and macro-economic pressures, Toyer says there is not a sense of panic among Investec's charity clients. "I think they are definitely more considerate in their decision-making in terms of what they are spending, and whether they are getting the most from their money – really maximising the benefits in terms of the investment strategies," she says. "The boards that we deal with are quite experienced investors and are at wealthy charities. A lot of our clients have been with us for a really long time and they have been in this situation before. I think many investors are waiting for the dust to settle. No one's making any snap decisions."

Toyer says that she is having a lot of conversations with clients around market strategy and where inflation is going. "We've been talking about recession for a long time now but it hasn't formally materialised. We're still on the cusp, which creates a lot of uncertainty. One thing investors like is to know what's going to happen in the markets over the next one to two years and being able to create a very clear economic forecast. We don't have that kind of certainty right now."

What fund managers need to do is to continue to offer reassurance and stability, says Toyer. "I think that's what most clients want to see from their investment manager. They will have tough questions around performance, asset allocation, positioning and outlook, because that's their job as trustees. But what they really want to know

FAST FACTS

- Over £3.2bn in charitable AUM and £39bn of total assets*
- Top 10 manager of UK charities, with over 80 years experience
- Donated £8.9m to community projects and over 9,000 volunteering hours in 2022
- Investec Beyond Business: created 53 social enterprises, with over 375 jobs
- UN PRI and UK Stewardship Code signatory

* As at 30 September 2022

is that we haven't dropped the ball, that we are close to the markets, understand the environment we are in, and are doing everything we can to protect their capital and help them meet their objectives.

"Our priority for our charity clients is to maintain a balanced portfolio. The worst thing we could do in a time of uncertainty is to take any big bets. That's not what you should be doing as a steward of a charity's assets."

> "The worst thing we could do is to take any big bets"

BUTLER-SLOSS VS CHARITY COMMISSION

From an environmental, social and governance (ESG) perspective, there is yet another factor that is adding to the uncertainty: the outcome of the Butler-Sloss vs Charity Commission case. The judgment made in April last year confirms that trustees have wide discretion to exclude certain investments based on non-financial considerations when making financial investment decisions. These principles are described as ethical investment in the Charity Commission's CC14 guidance, but have also been described as responsible investment. This wider approach appears to supersede the Bishop of Oxford case, where it was held that the purposes of the charity are usually best served by the trustees seeking to obtain the maximum return on investments.

However, there is still uncertainty and debate as to whether this is in fact the case. With updates on the Commission's guidance not likely now until the summer, this leaves a lot of charities in limbo, says Toyer. "The Butler-Sloss case confirms that a charity's remit in regard to investment decisions is wider. It puts the onus on the trustees to really consider responsible investment in the context of their charities values and in some instances consider more than just financial return if it means not compromising your values in other ways.

"The reality is that many charities have already been looking at ethical restrictions in line with their values. They want good ESG integration and are thinking a lot about impact. This ruling gives them permission to do that and hopefully the Commission's guidance, which we get in the summer, will be very much aligned with this ruling. If it isn't, I think there will be a lot of confusion."

ESG INTEGRATION AND STEWARDSHIP

Although the ruling confirms the general direction of travel, Toyer warns that there are other concerns that need to be taken into account when pursuing a purely ethical strategy. "Although you are not necessarily compromising the returns, by aligning values and excluding certain sectors or certain stocks, you're reducing the size of your investment universe and potentially increasing the risk of the portfolio and the disparity of the returns."

She says that the role of fund managers in furthering responsible investment is to help navigate this by encompassing ESG integration and stewardship. "Good ESG integration is now seen as a given when you are thinking about risk management, and looking at non-financial risks and how they might impact future financial return. ESG integration is absolutely essential to maximise the financial return of a charity. The stewardship side is also really important, because we are being trusted to act as a voice for our investor base. It is our responsibility to hold companies to account. So ESG integration and stewardship go very much hand in hand in creating that responsible picture.

"Generally, value statements differ across the sector, and that's the additional overlay you can provide with a bespoke portfolio. But even if you don't apply a values-based assessment, you can still invest responsibly with a focus on ESG integration and stewardship."

WHAT WE DO

At Investec, our Charities Investment Service underpins our corporate purpose to create enduring worth, living in society, not off it. We are responsible for preserving and growing the wealth that is entrusted to us by over 1,000 charities; supporting them in delivering their mission. Sustainability is core to our investment approach and we will aim to deliver your financial goals, while ensuring your values are protected. We will take the time to understand your charity and can provide local charity specialists through our 14 regional offices across the UK.

Investec is authorised and regulated by the Financial Conduct Authority. The value of investments can go down as well as up and you may not get back the full amount invested. Your capital is at risk.

Defence – a responsible investment or not?

Eschewing investments in armaments is generally accepted as a cornerstone of responsible investment, with the sector being one of the so-called "sin stocks" that responsible investors exclude.

However, is this still the case or has the war in Ukraine led to the sector becoming more acceptable in the world of responsible investment? Over the past year, there certainly has been some signs that things have started to shift in this area.

Globally, less than a quarter (23%) of investment funds labelled as sustainable have a stated policy of excluding military contractors, according to Morningstar Direct, a fund research and ratings provider. In addition, almost half (44%) of them had some exposure to military contractors, which compares to 60% of non-sustainable funds.

The firm does state that: "Most funds have very small exposures to the industry, as many military contractors are large companies with other lines of business."

Last year, Sweden-based SEB Investment Management updated its sustainability policy to allow a number of its funds that invest in equities and corporate bonds to invest in the defence sector from 1 April 2022.

"All our funds will continue to exclude investments in companies that manufacture, develop, or sell weapons that violate international conventions (such as cluster bombs, land mines, and chemical and biological weapons)," the firm said in a statement. "Also excluded are companies involved in the development of nuclear weapons programmes or the production of nuclear weapons."

Following the announcement, a spokesperson for the firm told the Wall Street Journal that the decision to allow some defence stock holdings was because "the serious security situation and growing geopolitical tensions in recent months – which culminated with Russia's invasion of Ukraine – brought this issue to the fore from a policy perspective and resulted in a changed position among some of the fund company's customers".

SEB is not the only financial institution that is taking this view. In March 2022, Reuters quoted analysts from American bank Citi as saying: "We believe defence is likely to be increasingly seen as a necessity that facilitates ESG as an enterprise, as well as maintaining peace, stability and other social goods", and "Recent events in Europe, we think, will significantly increase the likelihood of defence's inclusion in the EU's Social Taxonomy."

Meanwhile, after being denied funding from some banking institutions, the Latvian deputy prime minister is widely quoted as asking: "Is national defence not ethical?"

Whether individuals agree with including defence stocks in a responsible investment approach or not, it may become an interesting and important topic of discussion for charities to ensure that their investments continue to stay aligned with their causes and investment policies.

Perhaps a Bank of America analyst quoted by the Financial Times summed the overall situation up best when they said that the war in Ukraine "reminds us that, like most things in investing, ESG is complicated and nuanced".

stocks," the report states. "Of course, our exit from these holdings has not reduced overall carbon emissions, simply those that are linked to our own portfolio. This is a key reason we believe that encouraging action on decarbonisation is the most effective way for asset owners to exert positive real-world climate influence.

"Companies in the rest of the portfolio have also been successfully reducing their emissions."

CHURCH COMMISSIONERS

One charity that has attracted criticism for the environmental part of its responsible investment approach is the Church Commissioners, the charity investment arm of the Church of England. In November 2022, priests and organisations including Christian Climate Action and Extinction Rebellion took part in peaceful protests at 13 London sites. They were protesting the charity's continued investment in oil and gas companies.

Reverends Jonathan Herbert, Helen Burnett, Hilary Bond and Vanessa Elston called on the Church Commissioners, the Church of England's pensions board and 11 dioceses to stop investing in fossil fuel giants including ExxonMobil.

The Church Commissioners and pensions board have committed to divesting from all fossil fuel companies not aligned with the Paris Agreement goals by 2023. However, the organisations have refused to divest entirely from the industry, arguing that they can be more effective by engaging as stakeholders.

BEYOND THE ENVIRONMENT

It is, of course, important to remember that responsible investment is much broader than just investing in an environmentally friendly way.

In a more positive move, the Church Commissioners has announced that it will vote against companies in its investment portfolio that do not meet expectations on human rights. It will vote on whether to re-elect directors of companies that fail to meet its expectations, including those with named responsibility for human rights or board chairs. In addition, it will partner with data providers and proxy advisers to better assess companies so that transparency across the sector can be improved.

Dan Neale, social themes lead for responsible investment at the Church Commissioners, said: "We will use our vote with discretion, when we think it's appropriate to signal our disapproval to the management of a company that do not appear to meet our expectations of responsible business conduct with regards to respect for human rights." ●

CHARITIES FIT FOR THE FUTURE

10 May 2023
America Square, London

Topics include:

- A practical guide to starting your net zero journey
- Developing inclusivity and equity in a hostile financial environment
- Three untold stories of ESG investing
- ESG and the new era of economic uncertainty
- What does the Butler-Sloss ruling mean for the future of responsible investment?
- Cold truths about our warming planet

Sponsored by: Cazenove Capital

haysmacintyre Investec

Register today!

web: civilsociety.co.uk/ESG2023
email: events@civilsociety.co.uk
call: 020 7819 1200

INTERVIEW CCLA

Find it, Fix it, Prevent it – CCLA's approach to tackling modern slavery

An interview with

Dame Sara Thornton

Modern Slavery Consultant, CCLA

According to the global slavery estimates published last September, there are just under 50 million people across the globe who are in slavery; 28 million of those are in forced labour, 22 million are in forced marriages. And it is happening in plain sight.

"It's very easy for people to think that this is something that happens thousands of miles away and that it doesn't happen in the UK. Well, I'm afraid it does," says CCLA's Modern Slavery Consultant, Dame Sara Thornton. "When we talk about modern slavery, we use it as an umbrella term. So it includes trafficking, slavery, domestic servitude, organ harvesting, sexual exploitation, forced criminality, and forced labour. It's a very broad term but in all its forms, modern slavery it is about making money and exploiting vulnerable people. At its core it is an economic crime."

A former UK Independent Anti-Slavery Commissioner and Chief Constable, Dame Sara has been engaging with anti-modern slavery initiatives from a law enforcement perspective for a lot of her career. She soon realised, however, that more focus needed to be placed on prevention. "This is where financial services can play an important role," she says. "In fact, they are key to any effort to prevent modern slavery. The main area where they can play a part is by putting pressure on the businesses they lend to, or invest in, that might have links to slavery and trafficking. It's about engaging with companies and encouraging them to do the right thing."

> "It's very easy for people to think that it doesn't happen in the UK. Well, it does"

FAST FACTS

- No. 1 investment manager of UK charities*
- £13bn+ in assets under management**
- 60+ years of ESG investing
- £15tn+ of assets supporting CCLA initiatives in mental health, modern slavery and climate change
- 160+ diverse team of staff across the UK
- Early signatory (2007) to Principles for Responsible Investment (PRI)
- 5* rated by PRI for listed equities

*Charity Finance Fund Management Survey 2022
**CCLA: Internal as at 31 December 2022

COMMITMENT TO CHANGE

This realisation brought CCLA to Dame Sara's attention. She met with chief executive Peter Hugh Smith and he offered insight into the work they were doing around investor engagement and modern slavery. Dame Sara explains: "I could see that CCLA not only had a keen interest in its own role in terms of its investments and how it could invest for good, but was also trying to bring other investors together to act jointly. And I believe very strongly that joint activity can be so much more powerful."

CCLA has a long-standing commitment to human rights and its highest exposure to modern slavery is likely to be through the companies and assets held in client portfolios. Recognising the important role that investors can play to make change happen, CCLA created the Find it, Fix it, Prevent it initiative that aims to bring investors together to help improve the efficacy of corporate actions to find and fight modern slavery in their supply chains.

To date, this programme has received the support of investors with assets under management in excess of £12.8tn and has seen real improvements in corporate

practices through its engagement strategies. "What I like about CCLA's approach to fund management is that it is not about divestment at the first sign of trouble. It's about building capacity to improve and, if you find that there are issues with slavery and trafficking, making sure you seek them out and address them.

"The fund managers at CCLA with whom the charities engage are in constant contact and communication with the sustainability team to ensure that they can answer any questions and be absolutely straight and clear that they are not only looking after the financial side of the investment, but also sustainability and value-alignment."

PILLARS OF THE PROGRAMME

The Find it, Fix it, Prevent it initiative is built around three main pillars. "Probably the most significant is collaborative engagement," says Dame Sara. "How can we, as investors, engage with the companies in which we hold equity to encourage them to address the issues of slavery and trafficking?"

The project's first focus was on hospitality, which is a high-risk sector. CCLA is now also working with construction companies, and issues around seasonal workers across sectors. Dame Sara explains: "Investors are collaborating to engage with the companies, asking whether they have found evidence of slavery and trafficking. If not, can they show that they have looked hard enough? If they have found it, what have they done about it? How have they recompensed workers? What have they done to prevent it from happening again? So, it's not simply about stopping it; it's about putting right the harm that has been caused."

> "It is not about divestment at the first sign of trouble"

The second aim of the initiative is around policy. The law in the UK as it stands is informed by the Modern Slavery Act, which requires businesses with a turnover of more than £36m a year to publish an annual modern slavery statement. "This is good as far as it goes," says Dame Sara, "but reports and consultations suggest the law needs to be tougher and tightened up. For example, there should be civil penalties if you don't fulfil reporting requirements; there should be a deadline for when you report; there should be certain categories of information you must include; and requirements should apply to the public sector as well as the private sector. I believe we need more of this kind of regulation to create a level playing field."

The third area of the programme is around company ratings and data. "The information that rating agencies provide when it comes to the 'S' in environmental, social and governance (ESG) investing isn't always helpful. It tends to rate controversy and downgrades companies that have reported issues around slavery and trafficking. One of the frustrations is that we are saying to companies that it is really important that if they find issues they report it, are transparent and open about it, and deal with it. But if a rating agency downgrades them as a result, where is the incentive?"

Data feeds into this because it doesn't always give the complete picture of how a company is performing and can skew the quantitative information upon which decisions are made. "We are looking at past reporting in modern slavery statements, and working out what we might do to make it more meaningful. We're talking to academics about the use of machine learning and AI so that we can rapidly ingest the information and pull out the key insights. Because we do need better data. At the end of the day, people need that numeric information in spreadsheets when they are making decisions.

"When you speak to survivors of slavery and trafficking, there is a huge amount of rich, qualitative information, which is very hard to capture in the quant systems that investors and businesses tend to use. That makes it hard to ensure the survivors' voices, those with lived experience, are being heard."

CCLA
GOOD INVESTMENT

WHAT WE DO

CCLA is the UK's largest charity investment manager. Firmly believing that healthy financial markets depend on healthy communities, CCLA has a long track-record of instigating change for a better world with its pioneering work on climate, modern slavery and mental health. Founded in 1958, CCLA is independently owned by its clients and staff with £13bn of assets under management as at 31 December 2022.

Pension power – responsible investment and charity pensions

Lisa Stonestreet looks at how all charities can invest in a responsible way through their pension schemes, and encourages them to take action

> "72% OF CHARITY EMPLOYEES BELIEVED THAT ETHICAL INVESTMENT IS ONE OF THE MOST IMPORTANT FACTORS FOR THEIR PENSION SCHEME"

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

RESPONSIBLE INVESTMENT and sustainable finance have rapidly gained attention within the last decade. Growing concerns around social, environmental and ethical issues and the role that investment and finance has to play in addressing them is being given greater attention in the media and among a wide variety of stakeholders. Consequently, there has been a significant rise in the number of individuals who are engaging with their own savings and investments, and in particular, their pension funds. People are asking important questions about how their money is being used and what kind of companies and activities it is funding. As this movement grows, so does the pressure, but also the incentive and desire for charities to consider the potential positive influence they can have on the pensions industry and the finance sector as a whole.

Many charities that we engage with are considering how they align mission and money in a number of areas such as their investment portfolio, including pensions in this ambition just makes sense.

Although we know that some large charities incorporate the thinking that they have done around their responsible investment policies into their choice of pension fund – and so extend their engagement on environmental, social and governance (ESG) issues to their pension provider/s and the funds and companies they are invested in through this – not all do, and we believe it's a significant omission.

Information about how charities incorporate responsible investment into their pension funds, or choice of pension fund, is not particularly easy to find. Of the 20 charities with the largest amounts of investment capital, only five explicitly mention on their website that they somehow include responsible investment criteria within their pensions. The others may do so, but the information is either not publicly available or isn't accessible via their websites. This is concerning not only from a transparency point of view, but also because there is enormous value in larger organisations sharing what they are doing. It is helpful if others can learn from their experience, so that their wider stakeholders, which can include both supporters and beneficiaries, can easily understand how they incorporate social, ethical and environmental considerations throughout their operations, including pensions.

> "How and why can a charity engage with pension funds?"

For charities without significant amounts of investment capital, their employee pension fund presents an excellent opportunity for them to engage with the finance sector and consider how their mission and organisational values are being incorporated into a financial product that they choose and interact with.

BETTER OPTIONS ARE AVAILABLE

A Guardian article entitled Pension Funds Catch Charities on the Hop, published in the year 2000 (https://bit.ly/3miqwJn), outlines how an occupational pension fund used by a number of large UK charities, namely the Pensions Trust, was invested in companies involved in the arms trade, genetically modified crops and petrochemicals – activities that clearly run counter to many charities' missions and values. This article highlights the reputational risk of not considering this area but it also shows the disconnect that can arise if charities don't consider all aspects of their financial investments and product decisions – why would a charity choose a pension fund whose investments undermine their good work? And how and why can a charity engage with pension funds to find a more sustainable way forward?

Twenty-three years ago, there weren't nearly as many options available as there are now, particularly with regards to environmental concerns. The range of pension funds that offer more sustainable approaches is growing. For example, in the UK, PensionBee now offers a Fossil-Free Pension Plan, which excludes the oil, gas and coal industries. It is also designed to avoid UN Global Compact violators and invest in companies that are transitioning to a low-carbon economy. Nest, the workplace pension scheme set up by the government, and a widely used auto-enrolment

scheme, has an ethical fund option that incorporates human rights, climate change and the environment, armaments and other ethical and governance concerns. Some of the charities we engage with regarding responsible investment more broadly, seem to operate under the mistaken belief that all pension providers are equal when it comes to social and environmental concerns. The fact is, there are better options available when it comes to these specific issues and it is important for charities to research this area thoroughly, particularly because charities are a unique type of asset owner.

THE BENEFITS OF HAVING A RESPONSIBLE PENSION

Charities, as organisations with a public benefit requirement and charitable objectives, have a significant responsibility to act in a socially responsible and ethical manner, both in their operations and investments. Offering employees a responsible or ethical pension fund option not only aligns with this responsibility and expectation but can also have several benefits:

1. **Attracting and retaining employees.** Many employees today, especially younger ones, are interested in working for organisations that align with their values. Offering a responsible or ethical pension fund can make the organisation more attractive to these employees, which can help with recruitment and retention. In 2010, the Pensions Trust found that 72% of charity employees believed that ethical investment is one of the most important factors for their pension scheme. Charity employees were found to find it particularly important that their pension providers were engaged shareholders.
2. **Demonstrating commitment to values.** Offering a responsible or ethical pension fund option shows that the organisation is committed to its values and mission beyond just its core activities. This can help build trust and credibility with donors and stakeholders.
3. **Mitigating reputational risk.** Charities face reputational risks if they are found to be investing in companies that engage in practices that are contrary to their values or mission. Offering a responsible or ethical pension fund option can help mitigate this risk by demonstrating that the organisation takes its responsibilities seriously and is actively working to align its investments with its values.
4. **Supporting a sustainable future.** Investing in responsible or ethical funds can help support companies that are working towards a more sustainable future. This can have a positive impact on the environment and society, which aligns with the mission of many charities.

All employers must now offer a workplace pension scheme and automatically enrol eligible workers in it. Pension provision could include providing access to a stakeholder pension scheme, a group personal pension or group stakeholder arrangement, or a charity's own occupational pension scheme. All provide opportunities for incorporating responsible investment issues.

> “Support companies that are working towards a sustainable future”

In the EIRIS Foundation's Ethical Money Action Plan we give an outline of how charities can consider pensions from a responsible investment perspective and help charities consider a number of ways in which they can answer the important question: Have you incorporated your organisation's values and mission-related considerations into your choice of employee pension fund/s?

We recommend that charities work through the following key points:

- Have you researched the responsible investment approach and ESG credentials of your pension fund/s?
- Have you clarified your organisation's investment beliefs on responsible investment and discussed these with your pension provider?
- If your default fund does not incorporate responsible and ethical investment considerations, are your employees given an ethical self-selecting pension fund option?
- Do you gather and incorporate your employees' views on ethical environmental, and/or social factors related to the management of your chosen pension fund/s?

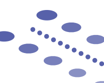
Charities have an influence that extends beyond the actual size of their investments or pension funds. When a charity asks questions of their asset managers and pension providers it can make a tangible difference to investment decisions and behaviours. This is happening already, but more organisations need to join this push and help create pensions, and a financial system, that are a part of the just and sustainable future we are all working towards.

USEFUL RESOURCES

The EIRIS Foundation's CharitySRI website provides information and resources on sustainable and responsible investment and ethical money – what it is, reasons for doing it and how to go about it in a way that is right for each charity. It features tailored advice, case studies of charities at various stages of responsible investment, explainers on key topics in SRI and other free resources.

The Pensions and Lifetime Savings Association Responsible Investment Hub has numerous resources which helps schemes to implement best practice on all responsible investment and stewardship issues. Many of the reports and guidelines listed in the hub can help charities navigate what they should be expecting from schemes that are prioritising this area and genuinely working towards improving disclosure and transparency on ESG issues.

Make My Money Matter has created a Green Pensions Charter which calls for all organisations to match their pensions with their values. A number of charities have signed up to this charter which in particular commits organisations to call on the pensions industry to agree net-zero targets for all investments and to engage with trustees and pension providers to explore how their staff pension scheme can align to net-zero before 2050. ●



Q&A SARASIN & PARTNERS

Sustainable spending – where can charities go from here?

Tania McLuckie
Specialist Charity Manager – Sarasin & Partners

Why was 2022 such a tough year for investors?

Few investors will look back on 2022 with fondness. Conflict in Ukraine, surging inflation and dramatically higher bond yields created a year of volatility and negative returns that left investors few places to hide. Global balanced accounts suffered particularly as bonds and equities fell in tandem – the first time we have seen this on any scale in nearly 30 years. UK government bonds produced a return of -24% last year, while index-linked bonds failed to provide inflation-proofing and instead fell by -34%, and global equities declined by 8%.

> Few investors will look back on 2022 with fondness

Many investment managers, ourselves included, were wary of the inflationary effects of the pandemic, but almost nobody anticipated the consequences of Russia's invasion of Ukraine. These two shocks in quick succession required central banks to raise interest rates sharply in a bid to contain inflation, marking the end of almost 15 years of central bank policies that had been highly supportive for equity and bond markets.

We estimate that the average charity portfolio lost about 20% of its value in real terms over 2022 and that there have only been five years since 1900 when real returns were worse: 1915, 1920, 1973, 1974 and 2008.

How has the investment landscape changed?

Last year was preceded by over a decade of strong investment returns driven by low inflation and falling bond yields underpinned by central bank policies and the deflationary effects of globalisation. Low interest rates and cheaper sources of labour – particularly in China and Eastern Europe – were good news for equity and bond investors. Our research suggests that many charities generated real returns of over 7% per annum over this period and had the opportunity to build up a significant real capital buffer.

> Many charities would benefit from an unconstrained global investment approach

The next decade is likely to be a decade of weaker returns: globalisation is reversing to some extent, the supply of raw materials, goods and labour is likely to be more constrained, and central banks are ending their supportive policies, which raises the cost of capital. Inflation is likely to settle at higher levels than we have been used to, but it may also rise and fall in waves. As a result, markets could be more volatile.

The good news is that after the trauma of 2022, bond yields are now materially higher than we have experienced in recent years, boosting projected returns from fixed income assets. At the same time, the returns from equities will benefit from structurally higher inflation, a more attractive starting yield and lower valuations than were the case 12-18 months ago.

FAST FACTS

Sarasin manages £8.2bn for over 490 charities* and not-for-profit clients

Charities represent nearly 45% of total business

*All figures as at 31 December 2022

How can portfolios be made more resilient?

In today's environment of lower expected overall returns and more volatile markets, long-term investment success is likely to be found in active, responsive management and diversification across a wider range of markets and asset classes. Equally important will be good housekeeping – particularly in terms of income and how much is genuinely available to spend.

We believe that many charities would benefit from an unconstrained global investment approach, which both widens the investment opportunity set and increases potential for defensive diversification. The benefits of diversification apply to income generation as well: focusing primarily on the UK market, where approximately 54% of all dividends come from just 10 companies in a handful of sectors, results in an unpalatable level of risk.

> “This year has brought a smorgasbord of opportunities – and risks”

We also recommend adopting a total return approach to maximise flexibility in generating returns while ensuring that spending is disciplined, such that savings are built up to support consistent spending during fallow years.

This year has brought a smorgasbord of opportunities – and risks. Markets are unpredictable and regularly make fools out of investors. However, a robust strategy that is well-diversified, evolves over time and is transparent in terms of income, liquidity and what one owns are all important elements in the formula for long-term success.

How much can a charity afford to spend over the next seven to 10 years?

Answering this question depends on the levels of investment returns that a charity has received during the good times, and how much of that it has already spent. However, while it's difficult to forecast short-term market returns, our analysis suggests that longer-term trends can be more dependable. Given this, we are able to make some general observations based on historic returns since 2011 and our projections out to 2031.

Interestingly, the expected real return – and thus, sustainable spending rate – over this period is likely to be about 4% per annum, which is remarkably close to the very long-run averages.

So, if one had achieved average returns and spent the long-term sustainable average of 4% over the past decade, then – even after the torrid past 12 months – one should be able to continue to spend 4% per annum over the next decade. Across the whole 20-year period from 2011-31, one could end with a little more capital in real terms than when one started.

A word of caution is needed: spending 4% per annum might not leave much of a buffer for the next storm. We suspect that many trustees will prefer to reduce spending and only increase it again when their capital buffers have been rebuilt.

SARASIN
& PARTNERS

WHAT WE DO

Sarasin & Partners LLP is a London-based asset manager that manages £18.3bn* on behalf of charities, institutions, intermediaries, pension funds and private clients, from the UK and around the world.

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

*All figures as at 31 December 2022

This information is for investment professionals only. If you are a private investor, you should not act or rely on this document but should contact your professional adviser.
The value of your investments and any income derived from them can fall as well as rise and you may not get back the amount originally invested. Past performance is not a guide to future returns and may not be repeated.
The index data referenced is the property of third-party providers and has been licensed for use by us. Our third-party suppliers accept no liability in connection with its use. See our website for a full copy of the index disclaimers. https://www.sarasinandpartners.com/docs/default-source/regulatory-and-policies/index-disclaimers.pdf
Sarasin & Partners LLP is a limited liability partnership registered in England and Wales with registered number OC329859 and is authorised and regulated by the Financial Conduct Authority.
© 2023 Sarasin & Partners LLP – all rights reserved.

INTERVIEW LEGAL & GENERAL INVESTMENT MANAGEMENT

Adopting ESG – getting it right

An interview with

Nancy Kilpatrick

Head of Charities – LGIM

Andrzej Pioch

Asset Allocation Fund Manager – LGIM

As 2023 continues apace, interest in responsible investing among charities is still on the rise. "At the moment, 99% of our inward inquiries from charities are about adopting environmental, social and governance (ESG) strategies," says Nancy Kilpatrick, Head of Charities at Legal & General Investment Management (LGIM). "Charities want to adopt them but there is still uncertainty about what the risk and return profile might be and whether the funds truly reflect their ESG requirements. Charities must ask their managers: What are you doing on my behalf? Is my investment policy being translated in the right way?"

Furthermore, ESG investing is constantly evolving and this also presents challenges, says Kilpatrick. "There are so many moving parts when it comes to tackling pressing issues such as climate change. Charities need to know that their asset manager is not only providing ESG-labelled strategies across all client assets, but also combining this with voting and using their scale effectively to influence real change."

> "Our methodology is very transparent upfront"

STRIKING THE BALANCE

To achieve this, LGIM Asset Allocation Fund Manager Andrzej Pioch says it is imperative that asset managers listen to the questions from clients. "If we want investors to pay attention, we have to first pay attention to investors, because we need them on board," he says. "When it comes to climate financing, for example, it's very much an all hands on deck scenario. However, we need to bear in mind when we pursue ESG objectives that we don't swing the pendulum too far in one direction and lose sight of other financial material risks. Sometimes we believe ESG investors can start fishing in a very small pond of companies leading to a concentrated portfolio, so it is important to maintain diversification, in our view."

Pioch says it is about striking the right balance between these two objectives. By asking the right questions, charities can aim to work out what the best ESG strategies are for them. "The key questions that investors should be asking are: Am I comfortable with the level of concentration that I have in my investments? Am I comfortable with the charges that I'm paying? When and how will my manager address other risks around recession and inflation? Is the portfolio well diversified? Can my manager also offer exposure to alternatives?"

LGIM aims to address concentration and minimise the impact of any implicit biases held in a portfolio, says Pioch. "One way ESG investors may consider doing this would be to look into creating a potentially well-diversified global multi-asset fund, aiming for a blend of active and index building blocks."

REPORTING IN A MEANINGFUL WAY

To keep investors on board, they have to understand how their funds are operating. For LGIM, communicating this is a key focus. Kilpatrick explains: "Our reporting is very detailed, and hopefully meaningful. It's all well and good having vast spreadsheets and lots of data, but whether that can be digested properly is key. As a client, you need to understand what your fund is doing. It's really important to report in a relevant, meaningful way and present it so that it is easy to understand."

FAST FACTS

- Top 10 charity manager
- £4.6bn of charity assets entrusted with us
- True active owners of capital
- 180,200 votes cast in 2021

Source: LGIM internal data as at 31 December 2021

Pioch agrees that when it comes to ESG reporting, the client needs to have all the facts to remain engaged. "Additional reporting is essential because having 'ESG' or 'sustainable' in the name of a fund is just not good enough. It's not clear enough because different people understand ESG differently. There is no commonly accepted definition. So it does require more due diligence of what ESG means in the context of that fund and whether that resonates with the client's objectives.

"Our methodology is very transparent upfront, because it's part of the index methodology. So we disclose exactly what metrics we use. And I think that helps to bridge the information gap between what the fund manager is doing and what the client wants to achieve. We can then have more in-depth discussions with clients about what's important to them and whether what we do really reflects their convictions."

Kilpatrick adds: "Charities are pushed for time and resource, so it's important to be able to speak about ESG in an understandable way. Don't overwhelm the investor with information because it's going to be counterproductive to reporting in any meaningful way."

REAL-WORLD IMPACT

Aside from stable returns, the reason a charity may choose an ESG strategy is to have real-world impact. "You need to know how this fund can make a difference in the world and in the underlying economy," says Pioch. "Ask your asset manager for specific examples of how the money they have invested has made a difference."

That impact has to come through engagement with the companies in the fund. "What did your manager achieve, for example, through engaging with companies that they invest in?" continues Pioch. "Are they sitting on the fence or abstaining when they have the opportunity to vote on shareholder resolutions or do they actually take the opportunity to influence the outcome? We believe it's our responsibility to vote on every share that we can. We pledge never to abstain. You need to engage with companies and say, 'how can we help you to do better?'."

The issue of voting says Kilpatrick is important to driving the change charities want to see. "Most managers now should be reporting transparently and giving a rationale on why they do certain things on behalf of their clients. It's not just about giving one example of engagement; it's about showing how we vote and how we are trying to influence the story and time lines. And it's not just about slapping people on the wrist; it's about giving an incentive for companies that are performing well within their sector to continue to do better. When one company goes that way, the others will follow because it means that they will get more investment."

WHAT WE DO

We are here to help organisations make the most efficient use of their investments. At a time when the call to the third sector is greater than ever, we partner with our clients to help them achieve their investment goals, whether that is long-term growth above inflation, income, seeking 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.

Key risks: For illustrative purposes only. Important Information: Past performance is no guarantee of future results. The value of an investment and any income taken from it is not guaranteed and can go down as well as up, you may not get back the amount you originally invested. Views expressed are of LGIM as at 2 March 2023. The Information in this document (a) is for information purposes only and we are not soliciting any action based on it, and (b) is not a recommendation to buy or sell securities or pursue a particular investment strategy; and (c) is not investment, legal, regulatory or tax advice.

Legal & General Investment Management Limited. Registered in England and Wales No. 02091894. Registered Office: One Coleman Street, London, EC2R 5AA. Authorised and regulated by the Financial Conduct Authority, No. 119272

Using our investments to help further our charitable cause

Macmillan Cancer Support recently took its first steps in impact investment. Tanya Humphreys *explains the process*

"OUR INVESTMENTS THROUGH THE PORTFOLIO ARE NOT GRANTS BECAUSE WE EXPECT TO SEE IMPACT AND A FINANCIAL RETURN"

Tanya Humphreys *is director of innovation at Macmillan Cancer Support*

RIGHT NOW, there are three million people living with cancer in the UK. This is set to rise to four million in 2030 as people are diagnosed earlier and treatments improve. The numbers are big but cancer is personal. Every person has their own complex needs, hopes and challenges to live life as fully as they can. However, people with cancer are not getting the support they need.

At Macmillan Cancer Support, we're seizing every opportunity to make a difference for the people we exist to support.

INVESTMENTS

Investing our money in the right way to deliver the most impact is not only a vital part of our 100-year history but our future too. After all, we are currently almost entirely funded by charitable donations from the general public. In 2021, 98% of our income – £227.5m – came from fundraising activities. The remaining 2% came from grant income and investments, and we are testing how we can potentially increase this amount with our newly launched Innovation Impact Investment Portfolio.

The Innovation Impact Investment Portfolio launched at the beginning of 2023 and is a new way for Macmillan to invest in groundbreaking innovations in cancer care. It is a test and therefore relatively modest: we're investing £3.5m over the next two years in the most innovative ideas and pioneering cancer products.

We are focusing on providing funding to start-up companies with a developed idea and a robust business strategy that identifies the potential to transform the lives of people with cancer and a clear roadmap to commercialisation and profitability.

We decided on early stage start-up companies because this is the stage where we feel we can have the greatest impact in identifying and supporting the development and adoption of innovations in cancer care. We expect to take a minority equity position (under 50%) in each of the portfolio companies. The impact Macmillan wants to achieve and the financial return we expect will be agreed strategically at the beginning of any investment. This will influence how we work with the innovators and the decisions we make throughout the process.

> "Investing in start-ups to drive impact is new to us"

Any money from successful investments will come back into the portfolio and can be recycled and reinvested into other opportunities, or put back into Macmillan, if we decide not to continue with the portfolio.

PARTNERSHIPS

Investing in start-ups to drive impact in cancer care is new to us – but we have been working in partnership for a long time. In fact, delivering crucial support alongside partners has been fundamental to the work we do for a long time.

For example, we spent a total of £171.6m on services for people living with cancer in 2021. We either fund our services directly, such as through the Macmillan Support Line, or by working with key partners such as the NHS, local authorities, health boards, and other charities, as I'll explain later.

The decision to set up the Innovation Impact Investment Portfolio was influenced and underpinned by the robust governance, processes, and principles that we already have in place, which have allowed us to invest and work in partnership responsibly for decades.

This includes committing to maintaining high ethical standards. We make sure that our activities and those of our partners and suppliers are in line with our values. We follow sector guidance and best practice, including Charity Commission guidance and the National Council for Voluntary Organisations' (NCVO) ethical principles.

ETHICS

Our ethics policy puts people living with cancer at the centre of our decision-making, and we regularly review and update this. Our policy and procedures help us manage ethical issues, such as deciding whether to accept or refuse a donation, partner with other organisations, or make an investment.

Our finance and audit committee monitors the financial performance of the charity, the performance of

Macmillan's investments and our investment strategies, as well as financial reporting, planning, and budgeting processes, compliance, corporate risk and our internal and external audit arrangements.

Investment policies, delegation of authorities, procurement and expenses policies are in place. We have defined accounting policies and financial controls for accurate and timely reporting.

We monitor our financial performance, liquidity, and solvency through a system of financial reporting that compares actual results against the phased annual budget and the latest quarterly forecast on a monthly basis. In addition, we prepare longer-term financial forecasts aligned to our strategic plans, incorporating scenarios, to confirm our longer-term solvency.

All of this gave us the sturdiest of foundations to launch the Innovation Impact Investment Portfolio earlier this year. The three key aims of Macmillan in setting up the portfolio are:

- To increase our reach and the impact of relevant innovations on the lives of people with cancer.
- Make the most of our money in a sustainable way, as well as get some money back to recycle into other investments.
- To influence and lead the sector and other organisations to invest in innovation in cancer care in a similar way, so we can see positive change for people with cancer.

Our innovation impact investment strategy is focused on companies developing solutions aimed at improving the lives of people with cancer in the UK, in line with our charitable objectives. We will choose innovations that have the potential to increase our reach, impact, and relevance, and will prioritise those that support the health system to address current and future challenges in cancer care and/or aim to address health inequalities. We are especially interested in those working in the key areas of focus for all our innovation work: improving earlier diagnosis (in line with NHS Long-Term Plan ambitions) and innovation in treatment (with an emphasis on equity of access and leveraging the benefits of data-enabled care).

We will aim to invest £1.75m in 2023. We have already invested in Neutrocheck – a portable device and accompanying app in development from 52 North Health – with the aim to help people with cancer test their risk of life-threatening neutropenic sepsis at home rather than having to be tested in an emergency at hospital. This could save time and reduce stress for cancer patients as well as reduce pressure on the NHS.

Investing in innovation in cancer care in this way is different to Macmillan's direct service offer and our grantmaking programme via partnerships with NHS organisations, local authorities and others. The grants we provide to our partner organisations are given as a gift to be spent in an agreed way, such as funding a specific service or role for a certain period, with agreed impact outcomes but no expected financial return. Our investments through the portfolio are not grants because we expect to see impact and a financial return.

> “We continue to work in partnership with Social Finance”

Similarly, it is not a social impact bond, which involves a contract to deliver a particular service and for some of our investment to be returned to us once a specific outcome has been achieved as part of that service. For example, we continue to work in partnership with expert social investment company, Social Finance, and have made two investments in supporting palliative and end-of-life care over the last 12 months. This partnership builds upon investments made as part of the Care and Well-being Fund end-of-life integrator that was established in 2015 and managed by Social Finance.

At Macmillan, we use these three vehicles (impact investments, grant, and social impact bonds) to achieve different types of impact for people with cancer.

EARLY DAYS

It is early days for us in terms of managing the portfolio and pipeline of investments. As such, we are initially working with some of the Academic Health Science Networks (AHSNs), NHS England's network of innovation agencies, to identify investment opportunities with the greatest potential for people with cancer. As these networks are part of the NHS, they are uniquely placed to support adoption and scale of innovation. The networks drive innovation through open calls for submissions to broad health challenges, for example an aging population, or very specific areas of focus, for example supporting early diagnosis of cancer. Eastern AHSN has been integral to our partnership with 52 North Health.

Nevertheless, we are already considering what the future may look like beyond 2024, if we see success from the portfolio. Macmillan could carry on investing alone (as we are doing now), or we could join forces with other investors to increase reach and impact.

To inform the direction we will take in future, we have set up a steering group, supported by an innovation board, to regularly review the performance of the portfolio, the balance between the risk, return and impact profiles of the individual investments, and the opportunities arising. We will report annually to Macmillan's board of trustees and our finance and audit committee. We will also commission an annual independent review of the portfolio covering value and impact.

As previously explained, managing our the portfolio is new for us as a charity. Our income – whichever way it is generated – is hard-earned. We have a duty to those that we support and those who support us to spend it responsibly. If and when we start seeing early signs of success as part of our investments, we will consider our options to potentially scale the portfolio up. Many opportunities may not be in spaces we can step into alone. Perusing the right partnerships is fundamental. But our ambition is that through meaningful investments, we will tackle future challenges to transform the lives of people with cancer for years to come. ●

Q&A NEWTON INVESTMENT MANAGEMENT

Asset managers will play a vital role in finding net zero

Hilary Meades
Head of Charity Investment – Newton Investment Management

How has your net-zero approach evolved?

The sixth and latest report by the United Nations' (UN) Intergovernmental Panel on Climate Change (IPCC) in August 2021 warned that the world would reach 1.5 degrees Celsius of warming by 2030 under all scenarios examined.

At recent UN climate change conferences there has been much talk but still a relative dearth of concrete detail over how net-zero carbon emissions would be achieved. What is clear though is that if we are to collectively hit the pledged net-zero targets, there will need to be an extraordinary and global effort, and asset managers will have a crucial role to play in the transition.

> “To hit the pledged net-zero targets, there will need to be an extraordinary and global effort”

At Newton, we have joined the Net Zero Asset Managers initiative, and have aligned ourselves with an independent methodology guided by the Science Based Targets initiative (SBTi). Through the latter, we are committing to having 50% of the financed emissions of the companies we invest in on behalf of our clients tied to credible net-zero plans by 2030, with the aim of reaching 100% by 2040.

We will seek to meet these headline targets via a range of transparent measures around investments in climate solution providers, engagement with heavy emitters to support their energy transition, and active stewardship activities.

We emphasise the importance of emissions pathways and we are led by science (and by the SBTi where the guidance is available). This forces us to focus on real-world emission reductions rather than superficial portfolio decarbonisation. This guides our priorities around focusing on the regions, sectors and companies that are the most carbon intense.

Why shouldn't investors just divest from heavy emitters?

We think that simply cutting out certain sectors is not necessarily going to translate into real-world decarbonisation, which is ultimately what we want to achieve. As active investors, we believe the right approach is not to divest completely from the high-emitting companies, but to engage with them while seeking to also allocate to companies that are doing the most to effectively create credible and effective transition plans.

Negatively affecting the cost of capital through mass divestment will not necessarily help a company change its business. Importantly, we also need to ensure that those plans are economically fair and socially inclusive, and aim towards a just transition, because we know that tackling such a multifaceted problem will create some trade-offs, and there will be winners and losers in the transition.

FAST FACTS

Four decades of global investment experience, with particular expertise in active equities, income, absolute-return, multi-asset solutions, thematic and sustainable strategies

Clients include charities, pension funds, corporations and, via our parent company BNY Mellon, individuals

Our investment platform harnesses both fundamental and quantitative analysis, which includes ESG and thematic research

We are, however, prepared to divest from securities where appropriate (and, of course, to exclude them where client or strategy mandates require).

What about charities that face reputational risk?

Our 2022 Charity Investment Survey showed that 59% of charities consider engagement to be the best way to manage climate-change factors in their portfolio. However, we recognise that for some charities, a long-term engagement approach might not go far enough fast enough, and that their journey to net zero may require divestment.

To address this, we manage a range of sustainable strategies which embrace stricter carbon standards. Our suite of sustainable strategies aims to encourage a better allocation of capital that leads to the generation of sustainable risk-adjusted returns for clients alongside improved long-term global outcomes for the society and the environment. In doing so, they seek to avoid companies involved in areas of high social cost, environmental degradation, or violators of the UN Global Compact Principles.

> “Biodiversity is likely to be the next issue to address”

We also offer exclusions and screening for our charity clients, and our active management approach means that we are able to be dynamic and flexible, in order to support clients on their own journeys.

How can charities navigate their own path to net zero and beyond?

The urgency of the issue is evident, with 76% of charities concerned about the push for net zero, according to our survey. Nevertheless, each net-zero path is likely to differ. Charities will need to think about their own objectives, and decide the best approach for themselves, which could involve setting out their targets in their investment policy statement.

The net-zero challenge has also highlighted other areas of focus for investors, such as biodiversity. Nature preservation and net zero are two sides of the same coin: protecting biodiversity in tandem with climate change is imperative, given that healthy ecosystems can help reduce the extent of climate change and better cope with its impacts. Biodiversity is likely to be the next issue that organisations and institutions will need to address, and is one that we are already looking at closely.

WHAT WE DO

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

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

This is a financial promotion. These opinions should not be construed as investment or any other advice and are subject to change. This document is for information purposes only. Any reference to a specific security, country or sector should not be construed as a recommendation to buy or sell investments in those securities, countries or sectors. Please note that holdings and positioning are subject to change without notice.

Newton manages a variety of investment strategies. Whether and how ESG considerations are assessed or integrated into Newton's strategies depends on the asset classes and/or the particular strategy involved, as well as the research and investment approach of each Newton firm. ESG may not be considered for each individual investment and, where ESG is considered, other attributes of an investment may outweigh ESG considerations when making investment decisions.

Issued in the UK by Newton Investment Management Limited, The Bank of New York Mellon Centre, 160 Queen Victoria Street, London, EC4V 4LA. Registered in England No. 01371973. Newton Investment Management Limited is authorised and regulated by the Financial Conduct Authority, 12 Endeavour Square, London, E20 1JN and is a subsidiary of The Bank of New York Mellon Corporation. 'Newton' and/or 'Newton Investment Management' is a corporate brand which refers to the following group of affiliated companies: Newton Investment Management Limited (NIM), Newton Investment Management North America LLC (NIMNA) and Newton Investment Management Japan Limited (NIMJ). NIMNA was established in 2021 and is comprised of the equity and multi-asset teams from an affiliate, Mellon Investments Corporation. NIMJ was established in March 2023 and is comprised of the Japanese equity management division of an affiliate, BNY Mellon Investment Management Japan Limited.

Q&A BAILLIE GIFFORD

ESG investing can drive resilience, longevity and growth

James Dow
Investment Manager, Responsible Global Equity Income
– Baillie Gifford

Why should a charity think about sustainable income?
Ideally, a charity's investments will meet three financial goals: resilience, longevity and growth. Resilience means that even in difficult economic times, the investment should still be able to fund the charity's expenses. Longevity means the investments should last for many years to support the charity's ongoing mission. Growth means that even if inflation is increasing the charity's costs, its investment returns should at least cover those rising costs and better still exceed them, allowing the charity to fund more expenditure.

> “ESG challenges are long-term in nature”

The traditional way of investing for charities was to seek investments with a high yield, which seemingly delivered more income per unit of capital invested. The problem is that strategy usually fails the goals of resilience, longevity and growth. A high dividend yield is often symptomatic of a company that is either overpaying an unsustainable dividend or running out of growth opportunities. There is a high risk that such income will eventually get cut, failing the longevity test. We saw this during the pandemic, when many high-yield investments reduced or cancelled their distributions, which, together with interruptions to fundraising activities, forced some charities to pull their support at a time when it was most critical.

A much better strategy, we believe, is to focus on sustainable income. This means focusing on investments which, by definition, should be resilient, long-lasting, and growing. Typically, these investments will have slightly lower dividend yields. But they are likely to be far more resilient. They are likely to last far longer. And they have a much better chance of growing ahead of inflation. A sustainable income approach is therefore much better suited to a charity's long-term financial goals.

What does a long-term investment horizon mean for environmental, social and governance (ESG) analysis?
ESG analysis has now reached many corners of the asset management industry, at times turning into outright greenwashing. For charities, ESG issues can be particularly important, and expectations are high. Charities are often at the leading edge of raising social, sustainability or governance issues with the companies they invest in.

One thing to remember, however, is that some of the most critical ESG challenges are long-term in nature. Think of climate change or biodiversity loss, for example. These are slow-moving changes whose effects will take decades to materialise.

For investors, we believe this means spending time delving into these issues to understand the long-term impact they have on companies they invest in, rather than outsourcing the analysis to ratings agencies like MSCI or Sustainalytics. It also means building relationships with companies over the years to accompany them on that journey.

A long investment horizon allows time for that in-depth assessment and relationship building, ensuring the focus is on addressing material issues that will continue to be relevant, rather than tackling the ESG issue of the day.

So, in our view, charities should require their investment managers to undertake serious analysis,

FAST FACTS*

Over a century of investment expertise.

Managing approximately £5bn on behalf of our charity clients.

Over 50 years of building long-lasting relationships with charities.

*All figures as at 20 March 2023

do that analysis in-house rather than outsourcing it, and think long term when assessing ESG topics.

Are there any other benefits of this strategy?

There are additional benefits for patient investors with a long investment time horizon.

To begin with, most financial market participants are fixated on the short term. Companies give guidance on next quarter's results, analysts and brokers discuss short-term prospects and many investment managers are incentivised on short-term performance.

We believe this fixation leads market participants to confuse noise and signal, creating mispricing opportunities for more patient investors. For example, long-term dividend compounders are rare, but often mispriced by the market.

A long investment horizon also gives managers the freedom to spend time on deep and meaningful research. Understanding a business and its long-term prospects takes time, which you are unlikely to spend if you are a shareholder for only a few months.

So, if the odds of delivering better performance are higher for long-term investors, why aren't we seeing more managers adopt a similar stance? Mostly because many investment managers do not have the incentive nor the structure in place that would allow them to. Investing for the long term involves the risk of deviating from performance benchmarks over short periods of time. In most cases, this is a risk they are not willing to take.

Can investors really influence change?

Yes, investors can really influence change. And they should, since they are stewards of their clients' capital.

Voting is the simplest way for investors to influence companies' decisions directly. Hence the rapid increase over the past few years in the number of shareholder proposals put forward at company AGMs, often related to ESG issues.

But voting is not the only way. Engaging with companies and probing them on relevant ESG issues is another constructive way for investors to influence change.

The challenge, however, is that the decisions companies make on some issues today may not pay off in the future. So, for an investor holding shares for just a few months, there is no incentive to push for action which will necessitate costly changes in the short term for an uncertain result in the long term.

Again, the chances of having a real and positive impact on a company increase with being a long-term supportive shareholder. It helps relationships to form and aligns with the objectives of management teams which also take a more patient approach.

In summary, investors can, and should, influence change. And we believe charities can, and should, challenge asset managers to use their scale, expertise and access to push for that change.

WHAT WE DO

Our sole purpose as a firm is to help our clients meet their investment objectives over the long term. Baillie Gifford has over a century of investment experience and has been helping charity, foundation and endowment clients meet their investment objectives for over 50 years. As a private partnership, we have the stability to be able to take a long-term approach, which prioritises the search for sustainable growth and superior returns. We seek the best opportunities from around the world and combine them into high-conviction portfolios, delivering results which are very different to those of any other index or manager. We manage investments for a broad range of charity clients spanning areas such as healthcare, education, faith and the arts. Our clients' investment focuses range from equities to multi-asset mandates, from income to total return objectives, and from ethical considerations to societal impact.

For professional use only. All investment strategies have the potential for profit and loss, your or your clients' capital may be at risk.
Baillie Gifford & Co and Baillie Gifford & Co Limited are authorised and regulated by the Financial Conduct Authority (FCA).

Fixing responsible investment's democratic deficit

Dominic Burke *argues that the current model of responsible investment needs to change and involve those that are truly affected by the issues it seeks to address*

"SHAREHOLDER ENGAGEMENT STRATEGIES ARE RARELY INFORMED BY MOVEMENT ACTORS AND FRONTLINE COMMUNITIES"

Dominic Burke *is investment director at Lankelly Chase*

RESPONSIBLE INVESTMENT is typically approached as a matter of what, or what not, to invest in – be it best-in-class fund managers, sustainable businesses, exclusion lists, or goals for shareholder engagement. It's less likely to involve shifts in how foundations' endowments are stewarded and by whom.

In their grantmaking, however, foundations are increasingly prioritising questions of who and how, as much as what, including through participatory approaches intended to shift power over funding strategies. It's time for a parallel evolution in how foundations understand responsible investment, not only to ensure that all of our assets are accountable to our mission, staff, and grant partners, but ultimately to transcend what Social Movement Investing by the Centre for Economic Democracy's called the "capitalist logic of profit maximisation and privatisation that undergird the very problems we seek to remedy".

In so doing, we must ensure that our efforts are connected to wider struggles to democratise finance. Otherwise, they will amount to "Potemkin villages", behind whose facades trillions of dollars in pension and sovereign wealth continue to monetise, extract, and privatise social and ecological wealth.

STRUCTURAL SILOES PRIORITISE THE PROFIT MOTIVE

Strategies of separation operate at each stage of the investment chain, often shrouded in technocratic justifications, such as specialisation, while serving to shield financial actors, and ultimately capital, from democratic oversight and direction.

Within foundations – which, as owners of capital, are considered to sit at the top of the chain – investments tend to be siloed from grantmaking. Investment committees, generally comprising trustees and advisers selected for their financial know-how, typically shape investment strategy with no input from or accountability to staff and grantees, and often very little from the wider trustee board either. In some cases, strategy is effectively outsourced to external investment managers and consultants. Success is measured according to how well an institution's investments have fared in quantitative terms compared to peers or the broader market.

> " In some cases, strategy is effectively outsourced "

A 2022 report by the Grant Givers' Movement, called Ethics in Philanthropy, found that "65% of respondents said they were very interested or extremely interested to learn more about investments but gaining access to these spaces was challenging. One respondent stated: 'It [investment] is purposefully kept extremely exclusive – I have tried for several years to be included even as an observer in the meetings, with a specialist interested in responsible investment, and so far, have had no success.'"

The 2020 ESG Olympics process run by Friends Provident Foundation, alongside the Blagrave Trust and Joffe Charitable Trust, is perhaps the exception which proves the rule. A number of aspects of this tender process were held publicly, including a fund manager selection event to which grantees, other foundations, and indeed journalists, were invited to attend and contribute.

When it comes to the fund management firms which manage money on behalf of foundations, it's not uncommon for clients – especially those that are smaller in size – to be kept at arm's length from the individuals who make investment decisions, ensuring that difficult conversations about ethics can be deflected at the door.

Where fund management firms undertake engagement with companies to address social and ecological impacts, their analysis relies heavily on investor-oriented, and generated, research. Shareholder engagement strategies are rarely informed by, let alone undertaken alongside, movement actors and frontline communities who are closest to the issues.

Finally, company boards of directors are insulated from accountability to any stakeholders other than investors. ShareAction's 2021 Future of the AGM report noted that only those in possession of a company's shares are able to attend annual general meetings (AGMs), the sole opportunity to ask questions of board members and address investors. In 2020, 80% of FTSE 350 companies held their AGMs

behind closed doors, with no provisions made for participants to attend virtually or otherwise during pandemic lockdowns. ShareAction's report calls for stakeholders to have access and participation rights in AGMs. It says: "For companies to truly understand their impact, and for investors to hold them accountable, they need to hear from a wide range of people. It is the workers of a company, their suppliers or those impacted by a company's activities who tell the real story of its impact beyond the bottom line. No other forum exists for companies, stakeholders and investors to come together and engage in a dialogue."

The cumulative effect of these sealed echo chambers is that much of the activity which occurs under the banner of responsible investment is anti-democratic and geared towards preserving and accumulating capital. It means that investors engaging with companies on human rights violations, for example, appraise and address them through the lens of financial materiality rather than restoration.

In The Wall Street Consensus, professor Daniela Gabor argues that even where investors appear to accept responsibility for more than the financial performance of their individual portfolios, their involvement in policy and regulatory responses to social and ecological crises serves to "reorient the institutional mechanisms of the state towards protecting the political order of financial capitalism against climate justice movements and Green New Deal initiatives". For example, "investors strive to become the epistemic guardians of green taxonomies. By controlling the grammar of green finance, they can apply the 'green' or 'sustainable' label to asset classes that have a negative environmental impact, a greenwashing exercise that effectively waters down climate regulations in order to protect profits". Indeed, at the end of March 2023, the European Commission was reported to be considering gutting its flagship sustainable finance framework following complaints by asset managers that its requirements are too stringent.

SOLIDARITY ECONOMIES MODEL ALTERNATIVES

Thankfully, at the edges and interstices of the financial system, parallel practices are being cultivated which "democratise, decentralise and diversify economic activity" towards "a visionary economy for life", to quote Movement Generation Justice and Ecology Project's Banks and Tanks to Cooperation and Caring: A Strategic Framework for Just Transition.

Letting Go, Meg Massey and Ben Wrobel's 2021 book on philanthropy and impact investing, profiles a number of these, including Boston Ujima Project's "democratic investment fund", controlled by working class communities of colour, and Thousand Currents's Buen Vivir Fund, governed by a members' assembly made up of grassroots lenders from South America, South Asia and Sub-Saharan Africa.

> "The solidarity economy movement is not a new movement"

In the UK, a group of foundations has recently started a learning journey, organised by the Joseph Rowntree Foundation, to engage with "community and ecological wealth building in the solidarity economy". Barking and Dagenham Giving has already established a community-directed endowment to invest and allocate funds raised through the London borough's levy on private infrastructure developments.

While Lankelly Chase and other funders may only be starting to catch up with this field, Dr Stacey Sutton reminds us that: "The solidarity economy movement is not a new movement. It has historical roots in Latin America. In the United States, it builds off the legacy of the Black liberation movement."

A SYSTEMIC APPROACH

It is essential to ensure that we are contributing to movements working to transform the wider economic and financial system. Philanthropic capital is not much more than a rounding error relative to the money which is currently controlled by banks, pension funds, insurers, and sovereign wealth funds. But it has the freedom and moral responsibility to act as a disruptor and catalyst of change.

This is unlikely to come about solely through prefigurative, prototype investment vehicles funded with philanthropic capital, but will require a "sustained effort to build counter institutions and more effective forms of democratic governance" across economies, as Fred Block wrote in Democratizing Finance.

Alongside participatory capital stewardship strategies for their endowments, movement-aligned funders will therefore need to close the loop back to their grantmaking. For example, UK think-tank Common Wealth is currently developing alternative proposals to individualised pension provision in order to address the role that the huge, unequal, growth of pension savings has played in bolstering the power of asset managers and expanding financialisation in order to meet the growing demand for returns. Positive Money, meanwhile, campaigns against the "democratic deficit" at the heart of the monetary system, including reimagining the role of private banks and public financial authorities.

REPOLITICISING RESPONSIBLE INVESTMENT

Given the long history of solidarity economics, and the increasing adoption of participatory approaches within grantmaking, it's past time for foundations to democratise our investment practices.

Trustees' legal duty to ensure that endowments are stewarded in accordance with charitable missions means that philanthropic capital can be uniquely catalytic in reconfiguring our unjust and unsustainable financial system.

While participatory prototypes can play a powerful role in prefiguring democratic investment practices, they will lack credibility if they are only allocated small carve-outs from foundations' endowments. Furthermore, democratising these relatively immaterial pools of capital will not by itself be sufficient to reverse the destructive social and ecological dynamics of our dominant economic system. Funders must ensure that their investment and grant strategies pull together, alongside wider social movements, to shift power in the economic and financial system. ●

INTERVIEW EDENTREE

England's rivers are in trouble. Now is the time for investors to act

An interview with

Carlota Esguevillas
Senior Responsible Investment Analyst – EdenTree Investment Management

Well publicised and frequently in the media, water pollution is a growing concern. The Environment Agency's most recent report found that only 14% of UK rivers meet good ecological standards. That figure hasn't changed since 2009.

"Each year at EdenTree, we set out our engagement priorities in different strategic areas, which we believe are important to our clients and charity investors, and to the public," says Senior Responsible Investment Analyst at EdenTree Investment Management, Carlota Esguevillas. "These are areas where we feel we can have an influence and drive change. Last year, one of those topics was water pollution."

> "Only 14% of UK rivers meet good ecological standards"

As responsible and sustainable investors, engagement is a vital part of EdenTree's work, and how it delivers impact for clients and charity investors. Being an investor in public markets is a really powerful way to influence company behaviour and drive better practices across the corporate world.

"We wanted to explore what we could do on the topic of water pollution which has not really been touched on by other investors and is somewhat neglected by capital markets," continues Esguevillas. "We've seen the huge impact that investor engagement has had on climate change and corporate behaviour. We wanted to galvanise the same sort of action in the area of water pollution.

"As responsible investors in the equity and fixed interest markets, we felt uniquely able to look further into this subject; we invest in eight of the integrated English and Welsh water and waste water treatment utilities and so we were in a position to engage with the majority of the sector specifically on river quality and pollution – to compare and contrast, and to understand for ourselves some of the drivers for the deterioration in river health."

UNDERSTANDING THE CHALLENGES

EdenTree has had conversations with a wider cross section of companies to understand what the challenges are to improving performance, and encourage better practice across the sector. The Environment Agency records that there has been progress in some areas, and fall back in others.

In January 2022 the House of Commons Environmental Audit Committee's report on Water Quality in Rivers went so far as to say "a chemical cocktail of sewage, agricultural waste, and plastic is polluting the waters of many of the country's rivers. Water companies appear to be dumping untreated or partially treated sewage in rivers on a regular basis". And yet, despite the importance of the issue and the extent of the problem, it is one with which the majority of investors have failed to engage.

"We were surprised in our conversations with companies around a lack of investor scrutiny," says Esguevillas. "We knew it wasn't a topic that our peers were engaging on, but for many of the companies we spoke to this was the first time that an investor had asked a question on this topic. For too many years, it's been off the radar for responsible investors, partly because a lot of it is private and often held in bond portfolios rather than equity portfolios, but also because climate change has been the main focus over recent years."

As well as businesses, EdenTree engaged with nonprofits and regulators to build a full picture

FAST FACTS*

35-year track record

£3.8bn of assets under management

*Figures as at 28 February 2023

comprised of different perspectives. The results of this period of engagement were published in its 2022 report – The Condition of Our Rivers.

Esguevillas says: "What we discovered is that there is a very complex set of factors involving not only water treatment and sewage outflows but also urban runoff, the construction and agriculture sectors, and the nature of the regulatory frameworks, all of which play a part in the pollution of our rivers.

"We want to see change in all these areas, but with the water companies we want to see investment into upgrading the infrastructure and see them set out clear, multi-year strategies of how they are going to reduce pollution incidents. They are only one player in a broader system, but we want to see them do everything they can so they are not contributing to river pollution."

COMMUNITY ENGAGEMENT

EdenTree's responsible business priorities are also reflected in its volunteer work. The publication of the report ignited a passion among EdenTree colleagues on the state of the nation's rivers and what they could do about it. As part of its corporate responsibility mandate, the investment management firm partnered with the charity Thames21 to organise a staff volunteer river clean-up day and raise awareness about pollution in the Thames.

EdenTree is also partnering with Olympic open water swimmer Alice Dearing and the charity she co-founded, the Black Swimming Association, to support young people to learn to swim and help raise awareness of the importance of water safety.

> "Investors have a role in pushing for the highest possible level of ambition"

These initiatives underline EdenTree's commitment to tackling issues around river pollution. Esguevillas says: "We feel strongly that investors have a role to play here in navigating public policy to inform and engage the regulator, parliamentarians, the Environment Agency and of course water utilities. Continuing a regulatory model that does not focus enough on environmental investment will lead to the continual erosion of a viable river-based ecology – one that is harmful to wildlife and of little attraction to the public.

"Our engagement with the industry has revealed a passion for improvement and incidences of good practice that are having an impact. Partnerships with a wide range of interested stakeholders are bearing fruit. However, there remain pockets of poor performance and inadequate plans for effective remediation.

"We'd love to see investors join us and ask questions of water companies, because these sorts of conversations are really useful in galvanising action internally and building a case for change. Clearly as investors, we have an influence and the more pressure that is put on these companies, the more likely we will get a positive outcome."

Esguevillas says that charity investors can really contribute to making change by constantly challenging their investment manager on their stewardship priorities and their engagement. When it comes to river health, "now is the time to act, and investors have a role in pushing for the highest possible level of ambition".

WHAT WE DO

EdenTree is a pioneer in responsible and sustainable investing, having launched the Amity UK Fund as one of the first ethical equity funds in the UK in March 1988.

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

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

Q&A EVELYN PARTNERS

ESG investment strategies can provide a safe haven in volatile markets

Nick Murphy
Head of Charities – Evelyn Partners

Caroline Jarvis Gee
Head of Charity Business Development England & Wales – Evelyn Partners

How can Evelyn Partners help charities to align their portfolios with their ESG principles?

Environmental, social and governance (ESG) principles form a charity's responsible investment policy. Evelyn Partners works with charities to understand their ESG objectives first, and then build a portfolio around these. Currently, we manage over £3bn in assets under management for 1,200 charities. From an investment perspective, while some charities are income or growth driven, most want to preserve their capital for future stakeholders. We rely on the strength of our central investment process to create truly bespoke portfolios which are aligned to each charity's risk and financial objectives. ESG considerations form a core part of our central process, with each of our internal sector specialists incorporating ESG screening as part of their fundamental company analysis.

We help each charity in an individual and bespoke way. Recently we worked with an education charity to create a portfolio that supports and promotes gender equality. Our client wanted a pragmatic approach to the promotion of women in the workplace and strong evidence of workplace diversity programmes across all products, services and operations in the companies in which they invested. As they want to promote a strong "direction-of-travel" approach, they rely on Evelyn Partners' company engagement to include those companies that have not yet achieved full alignment with the goals of the portfolio but are moving in the right direction.

In volatile markets, do charities need to forgo ESG investing?

Not at all! In fact, when markets are especially volatile, charities that invest in line with an ESG investment policy are often less susceptible to market downturns. The additional due diligence of screening investments against ESG criteria often unearths concerns that affect the overall investment case, thereby weeding out potentially weaker holdings at an earlier stage and creating a higher quality portfolio. While a general market slowdown can affect any portfolio, quality holdings have proven more resilient against downside risks.

Why is that? While most investors associate ESG mostly with the E, many forget that companies that are strong in their S and G criteria may, in times of market turmoil, provide safe havens for investors. These companies are historically associated with more diversification in their workforce and are more likely to have a culture that promotes innovation; vital when economic volatility can quickly wipe out traditional business lines as we witnessed during the Covid 19 pandemic.

FAST FACTS

- Actively engage and vote across all markets
- Signatories to the UN PRI, 2020 Stewardship Code
- Active members of the Investor Forum, Climate Action 100+, Find it Fix it Prevent it and Corporate Mental Health Benchmark
- Charity reporting including UN SDG and Carbon Emission Metrics

Which ESG themes are most important to charities right now?

In a word, all. Individual charities' ESG requirements are wide ranging, and we are happy to work with all of them. These have included promoting renewable energy transition and circular economy policies, supporting under-represented demographics or protecting the environment. Since the 2022 Butler-Sloss ruling, those charities which wanted to promote more environmental protection but previously felt it wasn't fully aligned to their mission, are now choosing to do so. Increasingly, charities are looking at specific ESG areas such as wildlife protection, water conservation and green energy. Evelyn Partners works with charities which have specific and finely tuned policies and those that want a broader "best efforts/best practices" approach to responsible investment.

> "Charities that invest in line with an ESG investment policy are often less susceptible to market downturns"

Recently, we have been working with military charities which are keen to enhance their ESG investing criteria. Some have not employed such criteria in the past, which is out of sync with Charities Commission guidance and the Ministry of Defence; others have adopted non-bespoke criteria which has inadvertently screened out entire sectors that their beneficiaries would probably want to see represented in their portfolios.

How can a charity approach ESG for the first time?

Charities must first decide if they want their ESG lens to be narrow or broad and create a policy defining their objectives. This is most often done in consideration of a charity's mission. While some charities focus on the E, S or G specifically, others prefer a "best practice" approach.

For example, while climate change is a pervasive concern across sectors, charities approach climate change mitigation from different perspectives. Some take a zero tolerance policy to high carbon emitting industries and others take a more Just Transition approach to promoting companies which are moving towards a renewable future. Regardless of approach, benchmarking against suitable parameters such as the UN Sustainable Development Goals, Paris Agreement standards or carbon footprint reporting provides charities with a useful foundation to measure their impact.

Evelyn Partners helps charities to navigate the finer points of an ESG policy and to understand how their choices affect their overall goals.

For more information, please contact **Caroline Jarvis Gee, Head of Charity Business Development England & Wales (Caroline.Gee@Evelyn.com)**

evelyn PARTNERS

WHAT WE DO

Evelyn Partners is the charity investment manager who believes in providing charities with a truly bespoke investment portfolio. We have a robust central investment process which provides the foundation and structure to manage risk at every level and provides our clients with the peace of mind that their portfolios are capturing long term trends, while managing short and medium term risks.

We were born of the merger between Smith & Williamson and Tilney Bestinvest with a history that dates back to 1836. Today we manage £53 billion in assets under management including £3 billion for 1200 charities (as at 31 December 2022). Our principles for managing charity money are simple: utilise a strong foundation made up of robust investment and risk management processes to provide charities with a bespoke investment portfolio that meets their individual and unique investment and ESG needs and peace of mind. For more information please go to www.evelyn.com/charities