Ethical investment:
MOVING VALUES UP THE AGENDA

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Chair:

ANDREW O'BRIEN
Head of Policy and Public Affairs, Charity Finance Group
Andrew leads on CFG's policy and public affairs work. This involves developing policies and representing members on a range of issues and putting forward the sector's case to policy makers. Andrew joined CFG in January 2015 from NCVO, where he was Senior Policy Officer with responsibility for funding and finance. He has also worked as Senior Parliamentary Researcher.

Panel:

DARRAGH EGAN
Investment Specialist, The Health Foundation
Darragh has previously worked as a fund accountant for a fund of hedge funds manager, Everest Financial Group in Australia. With over 10 years of investment industry experience, he has worked at Credit Suisse Asset Management and Daiwa Securities. He is responsible for the day-to-day management of the endowment, ensuring the fund is properly invested and safeguarded.

SIAN FERGUSON
Trust Executive, The Sainsbury Family Charitable Trusts
Sian is the trust executive of Ashden Trust, JJ Charitable Trust and Mark Leonard Trust. She also manages the Climate Change Collaboration—a group of four of the trusts formed in 2011 to support pilot and research projects to find ways of reducing CO2 emissions quickly. Sian has worked with the trusts and partners in the US and Europe to establish Europeans for Divest Invest.


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Roundtable

Panel:

JONATHAN HOARE
Director of Policy & Investor Networks, ShareAction
ShareAction is the leading charity on responsible investment, working to see companies become a greater force for good through investor engagement. Jon previously worked in Government across a range of policy areas and departments. He has responsibility for responsible investment networks including the Charities Responsible Investment Network.

STAN LEE
Trustee, Joseph Rowntree Charitable Trust
Stan is a graduate in Economics and Politics from Queen's University, Belfast. A qualified accountant, his career has been in financial and operational management and company administration in a broad range of sectors including the charitable. Now semi-retired, he combines involvement in the charitable sector with being a pension fund trustee and some consultancy. He lives in Surrey with his wife and two children.

TOM RUTHERFORD
Head of Charities, Lombard Odier
Prior to joining Lombard Odier in 2015 Tom worked in a similar role at J.P. Morgan Private Bank in London, where he also had led their international manager due diligence team between 2002 and 2007. Tom started his career in wealth management at Robert Fleming & Co. in 1997 working with charities as a portfolio manager. He is also a trustee at Swanswell, a leading national charity providing addiction services.

Investment, we often hear, is a complex field. The various macro and micro drivers of markets can be difficult to comprehend, hence the large industry built around managing charity assets.

Ensuring a charity's values are represented in the management of its assets further complicates matters, all the more if trustees wish to ensure the way their assets are run actually advances their mission.

But charities are increasingly taking this approach, and the best asset managers are expert at helping them do it.

Charity Times gathered an expert panel of charities and investment managers to discuss the issues leading the responsible and ethical investment agenda. The field has moved on significantly from when the discussion was held 12 months earlier, but some issues remain.

Although there are some barriers to investing in this way, particularly for smaller charities, these are not insurmountable. Help is at hand, and the potential for charities to do even more good in the world by thinking carefully about how their investments are managed and working collaboratively is huge.

What's in a name?

One thing that becomes immediately clear in discussions around ethical investing is that there is no one-size-fits-all definition. Even the term 'ethical' is sometimes disputed, meaning it can be a difficult issue to pin down.

An ethical approach could span from excluding certain sectors or companies, to applying environmental, social, and governance (ESG) criteria to potential investment targets, to lobbying for change within companies, to seeking a positive impact from invested capital, or any mix of these or new and emerging activities.

The terminology itself varies, with some investors preferring to talk about ethical investing, others refer to responsible or socially responsible investing, and the water is further muddied by confusion about where impact or social impact investing fits in overall.

Martin Rich is a trustee for Access – the Foundation for Social Investment. Rich says that the very fact that there is dispute over what constitutes ethical investing is somewhat troubling.

"I personally think that the fact that we're even talking about the term points to the root of the problem. The fact that there is a debate between ethical and unethical, the fact that these various terms exist and there's discussion about what they all mean, shows that we do not invest de facto according to our values."

Stan Lee, a trustee for Joseph Rowntree Charitable Trust, says simply that "ethics is good behaviour - do as you would be done by". Naturally, precisely what that means will vary depending on the organisation.

"For us when we talk about ethics it's about keeping in mind whether what we're doing is helping create the sort of world that we'd like to see. That means focusing on the core values that we share as a community — around simplicity and equality, and peace and stewardship of the earth."

Newton Investment Management investment relationship manager Jeremy Wells says charities exist to do something positive in society, and it is therefore reasonable to expect them to invest with that in mind.

A few years ago taking ESG factors into account was considered quite a progressive approach. However, Wells points out that thinking has moved on.

"We would look at ESG factors as a way of grading companies in terms of a different set of risks than, say, balance sheet risks," Wells says. "You should have a view on a company in terms of its financial safety or otherwise, and a view in terms of the treatment of its workers, its interaction with the environment and the rest of it. These are risk factors you'll consider whether or not you have a particular mission that your investments are aligned with."

And it is more than just theory. There is an expanding body of evidence to support the argument that well governed companies, which look after their staff and the environment, are better investment options long term.

Jonathan Hoare is the director of investor networks at ShareAction, a charity that champions responsible investors having a voice in bringing about positive change in companies' behaviour. Hoare says Sports Direct is a clear recent example of the risks companies face by not acting responsibly.

The sporting goods retailer has faced scrutiny for several years over its treatment of staff, including zero hours contracts, low pay, and poor or unsafe working conditions. The issue came to a head over the summer when media and Parliamentary scrutiny led to the firm admitting it had paid some of its workers less than the minimum wage and agreeing to back pay those affected.

"Increasingly and recently we're seeing where neglect of ESG factors has led to ill fortune for companies. Sports Direct is the example. If you look at their share price, it has slid to half what it was a year previously. There are lots of reasons for that, but a big part of it is a governance issue; that is - how it's being run, how it's treating its staff."

Lombard Odier's head of charities Tom Rutherford points out that the ongoing shifts in terminology that have taken place since the 1990s are unhelpful,
in particular the negative connotations that can flow from branding some investing 'ethical' and some 'unethical'.

While 'socially responsible investing' may be a better phrase it is hardly catchy, he says.

"I think the debate's moving on further," Rutherford adds. "There are a lot of mainstream investment managers that are adopting best practices as part of a self-fulfilling prophecy and that shouldn't be discounted."

Issues

Climate change loomed large over the discussion. This is probably not surprising given the environment's place in the ethical agenda, and the fact the meeting took place during a series of days of 30-plus-degree weather in September.

However, it seems that fossil fuels and their impact on the environment is no longer just largely a talking point in the investment community.

The 'mainstreaming' of climate change as an investment issue has occurred alongside an encouraging emerging international consensus on the range and nature of action required.

The Paris Agreement, coming into force in November, unites 197 parties (86 of whom had ratified the agreement at press time) in agreeing to make efforts to limit global average temperatures to well below 2°C above pre-industrial levels. Signatories will also pursue efforts to limit the temperature increase to 1.5°C above pre-industrial levels.

Signatories commit to make finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.

MARTIN RICH
Trustee, Access - The Foundation for Social Investment

Martin is co-founder of Future-Fit Foundation, dedicated to changing corporate and investor behaviour in pursuit of a sustainable future. He spent seven years as sales director at Social Finance, having previously spent 13 years in international investment banking for JP Morgan, HSBC and UBS. he has a passion for sustainable development and poverty relief.

ROB STEWART
Portfolio Manager, multi-asset team, Newton Investment Management

Rob is a portfolio manager on the global multi-asset team. At Newton Rob manages a number of portfolios which have an ethical/SRI mandate. He joined Newton in 2003, prior to which he acquired a range of experience at Goldman Sachs. Previously he worked at CIN Management as both a Japanese and UK portfolio manager. Rob is a Governor of a London school which has charitable status.

JEREMY WELLS
Investment Relationship Manager, Newton Investment Management

Jeremy is an investment relationship manager on the charities team. Prior to joining Newton in 2012 he accumulated high-level experience at leading investment institutions, including Scottish Amicable Investment Management, PDFM, Gartmore, and most recently as head of charities investments at JP Morgan. He is an associate member of the UK Society of Investment Professionals.

Roundtable

Further, signatories will work to increase the ability to adapt to the adverse impacts of climate change, foster climate resilience and low greenhouse gas emissions development, in a manner that does not threaten food production as well make finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.

Newton portfolio manager Rob Stewart says investors are increasingly taking practical steps on climate change.

"Fossil fuels has come from nowhere as an issue for divestment, to be right up there on the agenda," he says. "In my view the charity sector will be making really quite big waves on climate change in another year. I wouldn't have said that 18 months ago, I'd have said it's going nowhere and it's going to be tiny. But now I think it's going to be mainstream. It might be as big as a tobacco exclusion within two years."

Sian Ferguson, a trust executive with the Sainsbury Family Charitable Trusts, says the trusts look at climate change as a massive issue, and treat it as a humanitarian risk rather than an environmental one.

> *"Increasingly, charities are able to actually seek to further their mission with their investable assets"*

Indeed, the threat is so severe that conventional means of tackling the problem will not be effective, Ferguson says. Rather than change from within particular companies or even sectors, heading off the threat of human induced change to the planet's climate will require systemic change.

Opinions on the Paris Agreement have been divided over the speed at which it will work, and the non-binding nature of the commitments, Ferguson is clear that swifter action is required.

"Climate change affects all parts of society and we're not acting quickly enough. We see there's a real urgency in that particular issue, and it's different to other really important issues like childhood obesity and diversity. It needs more than the sort of changes to companies' behaviours and policies that can be achieved through shareholder lobbying. It requires a whole transition from a fossil fuel based economy, a high consumption based economy to a different sort of economy."

If climate change is joining the established ethical investment issues of arms, tobacco, alcohol, sex industries, and gambling, JRCT's Lee would like to see another issue become much more mainstream.

He says gender diversity in the finance industry is the "elephant in the room". While JRCT asks its fund managers to engage with the companies in which it invests to ensure there is gender diversity on their boards, the grant maker realised the same scrutiny was not being applied to fund managers themselves.

"It's awful in the US where there are single figure percentages of funds run by women. It's pretty dire in the UK, I think we still come up in single figures," Lee says. "So we're engaging with our fund managers on that issue in a very real way. Why aren't there more female fund managers? There are a lot of female analysts and then it sort of stops. There are a lot of women doing great work on the engagement side of it. So we've started this one running and we hope others will pick it up. And we found our fund managers really responsive. We look forward to a continuing conversation with them on this topic."

Approaches

Charities who wish to invest ethically have a range of options. They can exclude companies that clash with their values, or actively lobby the boards of their investment companies in pursuit of positive change, or they can combine the two approaches.

Increasingly, charities are able to actually seek to further their mission with their investable assets via the nascent but promising social investment market.

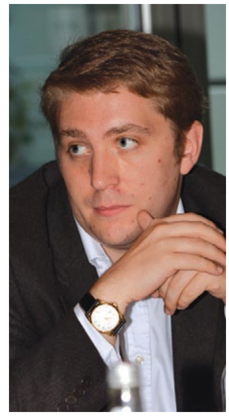
As for whether to exclude or engage, there is no universally appropriate answer. Ferguson says that for systemic issues like climate change, exclusion is the most effective approach.

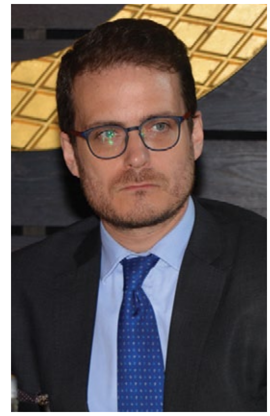
"We see issues around gender and diversity, child labour, the living wage as really important and ones that we can I think have some meaningful impact with through engagement and lobbying the companies," Ferguson says. "But when it comes to fundamental shifts in what the business is about we don't think that engagement is the route. We wouldn't buy shares in a tobacco company to try and make them close down. We wouldn't buy shares in an arms company and say 'stop selling arms'. We think divestment is a more effective tool than engaging when you're trying to accelerate away from a certain business."

However, Hoare says that engagement too has produced positive results. In the case of climate change, he says that not all petroleum companies can survive the transition to a low-carbon economy and investors will reward those that do make positive steps to reduce their impact or transition to new technologies.

Further, Hoare says that it needn't always be a binary choice overall, with divestment and engagement working in tandem.

"Those that are engaging can point to the people who've said 'that's it' and say 'look what is happening'. SOCO International was an example where there were some very high profile divestments which enabled those who were still engaging with that company to say 'look what is happening, we will follow them, you need to change what you're doing'. And that company did make some changes."





Access – The Foundation for Social Investment is a model example of another approach. Established last year with a £60m endowment from the Cabinet Office, Access takes a 'total impact' approach across its activities which sees it seek to achieve impact through all its actions, not just its grant making.

Rich says that the charity is fortunate to have been established with a clean slate, from which it could design a strategy perfectly in line with its goals and values.

As a 'spend down' foundation with a 10-year mandate, Access felt a fixed income approach made the most sense. Its endowment is therefore invested in social and ethical fixed income investments like charity bonds and other ethical bonds, in line with the foundation's 'Bulls Eye' impact framework.

The framework prioritises charities and social enterprises delivering social impact in the UK, followed by similar organisations delivering impact in other jurisdictions.

Other organisations delivering social impact are next in the queue, followed by organisations with best in class environmental, social, and governance indicators.

"We have our 'Bull's Eye' – 2 – 3 – 4 scale and every single asset in our portfolio is rated on that scale," Rich says. "Our target is to get all of our assets into the centre over time. We probably won't, not least because there are constraints around availability, credit quality, liquidity and so on. But we built that portfolio with that starting point and target in mind."

The ease with which a charity can pursue values-based investing can vary depending on its investment approach. Access started from scratch with a clear mandate, but those with legacy issues to unwind can have to do more heavy lifting.

Wells says issues can arise around the transparency of some pooled funds. It is an important area, he says, where at least half of the sector wants to invest ethically but many do not have large enough portfolios to secure segregated mandates. Finding solutions is a challenge for the fund management industry, he says.

"Embedding ethical factors in a

pooled approach is problematic. Ultimately it comes down to resource and the capacity of fund managers to look through the funds. Some can, we can, but not all can."

Sacrifices

If, as Rich observed earlier, there is an inherent problem in charity investing insofar as some or even a majority of investors do not invest in line with their values by default, it begs the question: why?

On the face of it, if an investor is ruling out sectors or businesses then this could lead to missed opportunities. Or simply, applying ethical restrictions could lower returns.

But the experts around the table had little time for this view. Indeed, Lombard Odier's Rutherford sensibly pointed out that if you could not make money investing ethically, no-one would do it.

"I have no doubt that returns don't need to be compromised by adopting the correct criteria," he says. "We incorporated ESG criteria into our entire research framework back in 1997. We'd be out of business if we didn't generate above-market returns."

And as Ferguson notes with some frustration, there is an increasing wealth of evidence to suggest that investing ethically need not limit returns.

"I just think; what else do you need to do?" she says. "We can all demonstrate it. It works. We can keep telling people this, and we can give the figures but why doesn't it get through?"

Charity Finance Group head of policy and public affairs Andrew O'Brien chaired the discussion, and highlighted the suspicion on the part of some charity investors and finance professionals that it all sounds a bit too good to be true.

If puzzled ethical investors ask why all trustees do not embed their values in their investing, equally those who do not may ask 'well, if it's so good why *doesn't* everyone do it?'.

Newton's Stewart raised some interesting results from empirical research the manager conducted into the impact of exclusion on portfolio performance. Measured retrospectively over a 14-year timeframe, Newton found that a total fossil fuel exclusion over a global portfolio made no difference to returns.

However, of the other main exclusions such as tobacco and weapons, exclusion did have a modest drag on performance. But this also depended on timing.

"There are quite dramatic - in the world of fund management anyway - relative swings between good years and bad years," Stewart says. "So you can look really clever having a divestment policy over a three year period, or you can look quite stupid."

Wells further stressed that the research is a starting point for debate, and any compromises on returns were "slender". The research also did not account for value added through taking an ethical approach.

Rich says that while Access had advantages such as starting from fresh and not having to invest in listed equity, the foundation's portfolio is entirely appropriate and replicable by others.

"We've not compromised at all. The risk we would've had to have taken to achieve any significant increase in return over our 10-year period would have risked losing as much if not more than we'd gain. So we have a safe, financially maximising portfolio as aligned as possible with our mission. Yes we have a fairly specific mandate, but everything we've done applies just as well to a lifelong endowment. You would have a different set of assets, you would have a different risk profile, but the approach and what you can achieve through that is utterly unchanged in my view."

Barriers

The panel agreed that resource and expertise represent a significant barrier to uptake of ethical investment, particularly for smaller charities.

Even with the best will in the world, with the multitude of other demands on a trustee board, finding the time to embed values in the investment policy while maximising returns can be a bridge too far for some.

"The sector is under assault at the moment," Rutherford says. "Auto-enrolment, SORP II, fundraising standards and many other issues often fall to the finance function and these are the same people who are making a decision in a short amount of time around their investments. Often investment gets pushed down the agenda, so sadly we [managers] come in at the end of the meeting, starting late, and need to finish in shorter time than we'd like. That's not an excuse on the part of the industry, but as a trustee myself I know how it comes about."

Managers can shoulder some of the burden. Lee says JRCT asks and expects its managers to work hard

"Different charities have different capacity to deal with things"

for the charity in terms of research and engagement.

But for charities with less capacity, they may not have the time to arrive at precisely how they would like their values reflected in their investments. Or, for similar reasons, may not have the confidence to ask the questions of those running their assets.

"Different charities have different capacity to deal with things," Stewart says. "They feel they should be engaging, dealing with their supply chain, talking to BP etc. - but they lack the resources to. That's where frankly I think fund managers have more than just a fiduciary responsibility; we've got to do some of this stuff *for* charities."

However, if managers are not receiving feedback on particular ethical issues, or ethical issues at all, they can feel they do not have a mandate to pursue them.

But Hoare, who coordinates the Charities Responsible Investment Network for ShareAction, says clubbing together can be a powerful tool for charities, and their managers, when it comes to responsible and ethical investment.

This is particularly true when looking at the overall ethical agenda, both in terms of smaller charities benefiting from the work and resources of their larger counterparts and in attracting more attention for emerging or more niche issues.

On gender, for example, members of the network have been able to apply JRCT's learning to their own situations. They have entered into joint engagement through CRIN to try to bring about change. The more investors that address the causes of gender in the fund management industry, the higher up the issue will be on the agenda.

"Then managers are starting to hear that with ethics it's climate and it's gender and it's poverty and it's risks around supply chains; it's all of these things," Hoare says. "Then hopefully managers are in a position where they can say to other clients 'we've looked at your mission, other clients are doing things in this space, are you interested?' Once the capability is there managers can easily offer these options to other clients."

Darragh Egan, investment specialist at the Health Foundation reported that reaching out to other charity investors may help influence managers to align their decisions with the charity's ethical stance.

"One of our fund managers made us aware that they intended to invest in a sector that did not meet the requirements of our investment policy. We worked with the fund manager and came to an agreement that they would set up an alternative fund that negatively screened the sector in question. Their decision was also influenced by the fact that other like-minded investors in the fund would consider switching if this modified version was established. It is an example of how there is strength in numbers if investors collaborate and work to achieve the same objective."

The types of personalities around the board room table play a big part.

Rutherford says the trustee boards that have taken an interest in the ethics around investment are very engaged, and "come from an informed position". But there are many that are not as motivated to take the area seriously.

"There's another problem we encounter often," he adds, "which is around the co-opted expertise within the investment function. Often fund managers who give their time to help charities don't necessarily come from the same background and same motivation. They come purely from a finance perspective, so the subtle changes we're seeing are where lay trustees are influencing the finance function."

Demographics play a part too. Ferguson says feedback suggests younger trustees tend to be more receptive to ethical considerations.

"More mature generations can be less receptive to change around some of these issues, and more loyal to traditional approaches which they have seen bear fruit. But younger generations are challenging that. Conversations around all of these issues can become quite troublesome around boards, and can be avoided or sidelined."

Unsurprisingly there is a political element too.

Rutherford says financial regulators in the UK have done little to further the cause of embedding non-financial factors. This is particularly true in contrast to their counterparts in France, he says.

"In France all fund managers have to report on the carbon intensity of their portfolios. To be labelled a compliant green investment fund you have to meet incredibly stringent standards. Nothing like this exists in the UK," Rutherford says. "Yes, France was home to the Paris Agreement, but this is an example of a marked difference where national policy is directing change amongst the investment community. We are far too insular as a charity sector investment community in the UK, we just look at our peers, and we don't challenge established practice."

"It's important to not be judgemental about it, but be encouraging about it"

The prize

Whatever the barriers to making values based investing increasingly mainstream, the benefits of overcoming them are significant.

Total charity investment assets under management value in the region of £90bn, and although this is a small portion of overall assets invested it still has significant capacity to affect change.

"It's essential that if there's one thing that comes out of today it's an encouragement to engage with this issue," Rich says. "If we could mobilise 100% of UK charity assets to chase these types of things - an ethical agenda - and begin to speak with something approaching a unified voice for good, even if the specific issues vary throughout that, then it would be an incredibly powerful signal and change would start to come. Then hopefully as a result these same trustees also start to think about the other pools of money that they own or influence in some way in their daily lives."

As Rutherford noted, dividing the community into 'ethical' and 'unethical' is unhelpful. While this does not mean those who wilfully adhere to poor practices should not be subject to scrutiny, Hoare says focusing on the positives is an important part of helping more investors join the ethical fold.

"It's a complex thing and the way we approach complex things as people is to try and simplify them into processes," he says. "If you've grown up with a process then it can be quite hard to move away from. I think it's important to not be judgemental about it, but be encouraging about it."

To learn more or be put in touch with any of the participants in this roundtable, email matthew.ritchie@charitytimes.com