Responsible investing:
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Chair:

LUCY TUSA
Principal, Mercer
At Mercer, Lucy provides investment consultancy services to foundation and endowment clients, pension funds, and charities throughout Europe. She advises on strategy setting, asset allocation and manager selection. She is a member of Mercer's Global Dynamic Asset Allocation (DAA) Committee and chairs the European DAA Committees. Lucy leads Mercer's European endowments team and European responsible investment team.

Panel:

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.

EDWARD MASON
Head of responsible investment, Church Commissioners for England
Edward is responsible for the implementation of the commissioners' ethical and responsible investment commitments. He took up his position in August 2014 having previously served for five years as Secretary of the Church of England Ethical Investment Advisory Group which advises the commissioners and the other national investing bodies of the Church on ethical investment.

Panel:

RICHARD MAITLAND
Partner, head of charities, Sarasin & Partners

After leaving university Richard worked for a leading securities house in South Africa before joining Sarasin & Partners in 1992. Richard carried out UK equity research and led the Third Party Funds research team, analysing specialist equity funds and alternative assets while managing portfolios for charities, pension funds and unit trusts. He now manages diversified multi-asset class portfolios for charities.

CANDIDA DE SILVA
Relationship manager, Family Offices, Charities and Endowments team, BlackRock

Candida de Silva's service with BlackRock dates back to March 2008. Prior to moving to her current role in July 2014, she held a number of positions, including head of EMEA retail marketing. Before joining BlackRock, de Silva worked for Goldman Sachs Asset Management and Mellon, including time at its subsidiary Newton. Previously, she spent four years in the publishing industry as an editor.

JAMES MONEY-KYRLE
Director of finance and support services, St John's Hospital

James has spent the past 15 years in executive roles in public, private and non-profit companies. A qualified accountant, he is the finance director at St John's Hospital. His role includes guiding the management of the charity's endowment investments. He is a board member of ACF, Charity Investors Group, an adviser to the Cabinet Office and holds professional qualifications from the London Business School and CIMA.

The concept of socially responsible investing is nothing new, dating back centuries in one form or another. That is not to say it is entrenched or ubiquitous in modern capital markets, far from it, in some areas of the finance community it remains a niche pursuit.

But the charity sector has historically tended to buck the trend on responsible investing. Relative to other large investors charities have often been at the forefront on incorporating ethics in their investment decisions.

This should come as no surprise given that by definition charities exist for a purpose beyond maximising their resources. However, the field of SRI is moving on and now encompasses much more than simply the stocks investors choose to avoid.

Charity Times brought together leading experts on SRI, both asset owners and asset managers, to discuss current thinking and where the debate needs to go.

Overall it was made abundantly clear that charities can ill afford to ignore the non-financial impact of their investment decisions. Recent history has plenty of examples of charities placed in an uncomfortable position by failing to keep a close enough watch on how their funds are allocated.

There is also a growing body of research indicating businesses that are strong on environmental, social, and governance (ESG) factors tend to be better run, and are therefore good long-term investments.

But most of all, SRI can also offer exciting opportunities to further a charity's mission.

"Everybody is becoming more conscious of responsible investment because they have realised that with investment you can't leave your morals at the door, and there's actually no reason to either," says Natasha Landell-Mills, head of stewardship at Sarasin & Partners. "An ethical or responsible approach to investment has to encapsulate how you pick stocks, what you do as an owner, and how you make a decision about selling."

Values

Trustees are legally permitted to invest ethically, even if this means accepting a lower rate of return, subject to certain criteria. The Charity Commission says trustees can exclude investments that conflict with their aims or alienate supporters, and make exclusions that do not result in "significant financial detriment".

The commission recommends trustees decide whether to adopt an ethical, socially responsible or mission related approach to investment, and ensure it can be justified. But this is not a requirement.

The charities around the table all take this consideration seriously. Edward Mason is head of responsible investment for the Church Commissioners for England, which runs around £6.7 billion in investments. Mason boils responsible investing down to how a charity aligns its investment practice with its values.

"How you invest reflects your character as an organisation, it has an impact on how you're perceived, it can affect your internal and external stakeholders so it's really important. In our statement of investment principles we say that the way we invest is an integral part of the witness and mission of the Church of England. It's about seeking alignment between the mission of the church and investment."

ShareAction is a charity dedicated to promoting responsible investment practices. Its Charities Responsible Investment Network brings together leading third sector organisations to pool knowledge and resources to use responsible investment to help support their charitable missions.

In its report, Your Money, Your Mission, ShareAction draws upon network members' experience to neatly encapsulate how charities can use their investments as a powerful tool for change.

The report identifies three key pillars to responsible investment. While the meaning of SRI differs between organisations ShareAction's framework provides a useful starting point. SRI takes into account and recognises the impact of ESG concerns in investment decisions, the report says, and utilises a range of tools for this recognition within a portfolio.

"Responsible Investment… can help to align a foundation's investment portfolio with its mission, ensuring that its investments complement rather than conflict with its charitable objectives," the report argues. "Aligning a foundation's investments with its mission enables the foundation to utilise more of its resources to support its charitable objectives and therefore increase its impact."

James Money-Kyrle is director of finance and support services at St John's Hospital in Bath, a charity with medieval origins that provides safety and care, support and social finance targeting social needs and disadvantaged people around its South West locality.

Money-Kyrle talks about the charity's approach to its assets as one of 'stewardship', seeking to preserve their value long term while also using them to achieve good.

"For our endowment we feel stewardship is the driving current for how we assess ESG issues around our investment policy. We want to use our assets for good, and that's our charitable mission. But the way we use them mustn't embarrass us or our beneficiaries. Within that we try and optimise the flexibility the board has for performance – both social and financial."

ShareAction's Jonathan Hoare sees SRI as "another tool in the box" for enhancing a charity's mission.

"There's a good opportunity here to improve the quality of what you're investing in, to give voice to your views and your ethics through your investments and the way that you behave as an asset owner."

In practice

While in the past the conversation on SRI focused heavily on whether ethics would get in the way of returns, the debate has largely moved on to implementation. *Fiduciary Duty in the 21st Century*, a recent report from a number of United Nations working groups, concluded that fiduciary duty is no obstacle to taking ESG factors into account in investment decisions.

"Sustainability is an important factor in the long-term success of a business," Al Gore and David Blood wrote in their foreword. "Therefore as with any other issue related to the prudent management of capital, considering sustainability is not only important to upholding fiduciary duty, it is obligatory."

Chairing the discussion, Mercer principal Lucy Tusa said SRI is becoming an increasingly dominant issue for charities. But if charities wish to incorporate ESG factors into their investment approach it is important to set out the organisation's intentions at the start of the process.

"You would probably be surprised at the number of charities that come to us who have created a portfolio and then want to have the discussion about ethics and put it into practice."

HANNAH SKEATES
Global head of sustainable investments, iShares, ETF business at BlackRock

Skeates rejoined BlackRock in 2013 as head of new markets for iShares in EMEA, after consulting on pan-financial services sustainability issues at a corporate-focused institution at Cambridge University. Prior service with the firm dated back to 1996, including years with Barclays Global Investors (BGI). Roles included head of business strategy and chief of staff for iShares in EMEA.

NATASHA LANDELL-MILLS
Head of stewardship, Sarasin & Partners

Natasha has a background in development economics and responsible investment. Prior to joining Sarasin & Partners, she spent over six years as the senior analyst leading ESG integration and several strands of policy work at the Universities Superannuation Scheme's Investment Management arm; and four years in Budapest working with OTP Fund Management and the European Bank for Reconstruction and Development.

JON HOARE
Director of 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.

Richard Maitland, who heads the charity practice at Sarasin & Partners, says keeping things simple gives charities a good chance of ensuring their ethical policies are in good order. And establishing a strong foundation to a charity's SRI activity is important to minimising the risk of public embarrassment, while also setting a charity on a strong footing in terms of engagement.

"Every charity has to have a policy. They then have to have good reasoning for whatever that policy is – which is going to be idiosyncratic to them. They then need to make sure they know how to implement that policy. If the policy is not being implemented perfectly, which it might not be for all the nuances we're aware of – size, scale, practicalities – then there needs to be good reasoning as to why the policy is suitable for them."

The responsible management of assets does not end once the exclusions have been decided and put in place. Like so many elements of managing a portfolio, best practice dictates that the ESG factors must be under ongoing scrutiny.

There are a number of reasons why, one of which is simply the need to keep up with changes in perception or awareness. Tobacco stocks, for example, would once not have raised an eyebrow but are now far outside the ethical boundaries of many investors. Similarly, oil and gas explorers were once completely uncontroversial stocks to hold. Now, high profile and well-resourced campaigns pressure investors to disinvest from these companies.

"This is a really dynamic area," Mason says. "We have an ethical investment advisory group that is constantly scanning the horizon looking at our previous exclusions – are they still fit for purpose? Are there new issues that are coming up? We've developed new screens in recent years covering things like US firearms and our new climate change screen."

"This is about acting on behalf of our investors and using our voice effectively"

Engagement

Ethical policies can be as simple as choosing particular sectors or companies to exclude. But, increasingly, they will include 'positive screening' whereby charities look to allocate to sectors or companies in line with their mission.

A best practice approach would include consideration of engagement with companies, through exercising voting rights or going even further to proactive communication with the board of directors of the company.

Maitland, who also sits on St Paul's Cathedral's investment committee, says charities must pay close attention to the management of the assets they own.

"Once you've decided what you're definitely not going to do, you need to spend the vast bulk of your energy on being a good capitalist and on the good stewardship of the assets you are going to own. If you don't invest in something, that is not really helping anybody but yourself. But if you do invest in something and engage – that's lifting the boat for everybody."

The Charity Commission recommends trustees ensure they are aware of the philosophy and processes behind their investment managers' voting policy.

Where charities choose to engage directly with the company they own, or have their managers carry this out on their behalf, the commission says such activity should be related to the aims of the charity and consider any risks.

Time and resources spent on engagement should also be "proportionate to the benefit to the charity", the regulator says.

Joseph Rowntree Charitable Trust takes a very hands on approach to engagement, and is clear in keeping its managers informed on what is expected. Stan Lee chairs the trust's investment committee, and says engagement with the companies in which it invests, via its managers, is "at the core" of how the charity performs.

"We want our managers to vote on things. We want to know how they've managed it. We want to know how they are looking at the companies," Lee says. "We want to be owners, we feel like we're owners in that very old fashioned capitalist way. So we expect our fund managers, perhaps not to have the same sort of fervour as some of us have, but to at least be aligned with it and be willing and able to take companies to task."

Partnerships

Lee's point strikes at one of the key themes in the conversation – the need for asset managers and asset owners to work closely together on embedding values in investment decisions.

Whilst companies have made big strides in reporting on ESG factors, open dialogue is required between charities and their investment managers to ensure all parties are armed with the information they need.

Hannah Skeates is global head of sustainable investments for Blackrock's exchange-traded fund business, iShares. She says charities can play a big part in ensuring ethical investment is effective by clearly expressing their values from early on.

"If charities can set out exactly what is important then we all end up in a much better place to take that investment through its life cycle."

But there are questions around the level to which charities can participate, or feel they can participate, in the engagement activity undertaken on their behalf.

Mason stressed the importance of charities being "empowered and confident" clients, who feel able to make demands and requests of their asset managers.

Money-Kyrle says that a great many charities lack the resources required to spend time quizzing their managers on their voting or engagement activities.

"Trustee boards have a duty to understand what they're trying to achieve with their funds and their investments, but equally they're not experts and rely upon the investment professionals to explain what's sitting in the wrapper. And that's where the investment community has a great role to play."

The managers around the table were clearly open to approaches on the issue. Indeed, Maitland urges charities to give their managers a steer on the issues that are important to them, to ensure the agenda being pursued is the right one.

Joseph Rowntree Charitable Trust see their managers as partners, Lee says, and frequently takes questions to them to ensure ethical concerns within the portfolio are being managed and potential issues are evaluated.

"Our trustees are very keen to lift the bonnet on everything that we do. And that means a bit of work, frankly," Lee says.

"Our asset managers are not short of input from trustees. As an example, most people would take BT as an investment. We had real doubts about it, indeed it was on our exclusion list for a while because of fibre optic cable and drone warfare. So we joined up a lot of dots and then went to our investment managers and said, 'we'd like you to engage with them on this', and they did. They did a splendid job. We felt that what we were paying our fund manager was good value for money."

Landell-Mills says working in partnerships is "incredibly important", but investment managers have to work hard to ensure the views of a diverse range of clients are being represented.

"We have a number of different charity clients and it wouldn't be fair to follow one cause and not think about everybody else. You do that by being very public about your voting and governance policy so clients are very much aware of how you will be voting."

Candida de Silva, a director in BlackRock's family offices, charities, and endowments team, described the balancing act that managers have to perform.

"Sometimes investors ask us around specific stocks and we bring in our corporate governance and responsible investment team. We publish stats on the engagement we conduct per region. We also publish the extent to which we vote against management proposals. We show case studies and give some very transparent examples of the types of issues in which we have engaged in constructive dialogue, and at times moved the dial. But nonetheless we prefer not to name companies publicly – that is not our role. This isn't about making publicity, this is about acting on behalf of our investors and using our voice effectively as one of the largest shareholders in the world."

Transparency

Ultimately SRI becomes near impossible without transparency, from investors, those who manage their assets, and the companies ultimately seeking to attract capital.

"Increasingly the power of communication and the power of engagement across whole communities, not necessarily just investors, is very compelling," Money-Kyrle says. "You can change opinion very quickly. That puts a moral pressure on trustees and boards to be clear about where they stand."

Processes used to choose financial investments should be included in trustees' annual reports, the Charity Commission says, including an explanation of any ethical investment approach adopted.

Many charities will need their managers to help them through the process of advancing the ethical agenda, so managers themselves need to set high standards. This extends to how transparent their own products, policies, and engagement activities are. The commission says charities are also likely to want regular reports on how their shares have been voted.

"Corporate governance is critical," de Silva says. "Some of our charity investors are starting to realise more and more that that's a question they need to ask of their manager, to really understand what is done on their behalf to achieve long-term value creation. Particularly for those who own passive investments."

Matters can become complicated where pooled funds are in use, as charities may find themselves invested, albeit indirectly, in companies that fall outside the set ethical criteria.

But the fact an investment is indirect is unlikely to protect charities from a backlash should they be revealed to be exposed to stocks that run counter to their values, or indeed are in breach of the ethical component of their investment policy.

"I'm aware that there are an awful lot of people within the sector who are saying one thing but doing something totally different because they're using pooled funds," Maitland says. "I don't want to move away from the ethical debate before the sector has put its house in order on transparency because we're just opening ourselves up to a line of fire. It's not good for the sector as a whole when anybody is publicly embarrassed. There is still some unfinished business on the strict ethics."

"How you invest reflects your character as an organisation, it has an impact on how you're perceived"

Solutions

That is not to rule out pooled funds altogether. Indeed, such products are an important piece of the overall SRI puzzle as charities with more limited investable assets will seldom be able to secure managers to run segregated mandates on their behalf. Furthermore, they would often lack the scale or expertise to run their assets themselves.

Tusa and Maitland agreed there are gaps in the market for products that go beyond a very standard approach. If investors wish to be actively engaged in companies and do more than simply avoid the most widely acknowledged 'sin stocks', they will not be overwhelmed by choice.

But if SRI becomes increasingly mainstream, products will be developed to fill the gaps in the market.

"The evolution in the amount of environmental and social data available on a vast number of different companies and sectors makes it possible to construct investment products that would have been very hard to construct previously," Skeates says. "That means we can evolve new products that move more from exclusion into ones tilted towards companies that have better ESG practices. In so doing, smaller clients may be able to find newer pooled funds that suit their requirements."

Careful thought is required when attempting to design new investment products that take ethical factors into account effectively.

Development of new products in this area suffers from something of a chicken and egg problem. Managers are understandably reluctant to develop solutions where there is unclear demand in the market, and that demand is difficult to demonstrate without available solutions to adopt.

Again communication was considered to have a major role to play in resolving the situation.

As much as charities need to be able to look to their managers for education and advice around SRI, investment professionals need feedback on the solutions trustees want in order to justify dedicating resources to developing them.

"We need feedback from the sector," Maitland says. "The charities need to make it commercially attractive for us, or at least give us a feeling of what they'd like. If we think there is demand we will be the first to get in there and innovate."

"We would agree ongoing feedback from charities is vital to asset managers," de Silva says. "While they don't deliver precise customisation, pooled funds play an important role in helping charities of all sizes incorporate ESG into their portfolio. We continue to build out products as we see demand. We've moved beyond pure negative screening to rolling out strategies which assess companies on their social as well as financial impact."

Networks

And charities need not go about this alone. Hoare says charities should not be discouraged from making requests because of their size, rather they should look around and establish whether the demand is there across a number of organisations.

"Charities can think about who else is in the same boat as them, who are the other charities that might also be interested in what they're asking for? And then work with each other to ask for it together."

Hoare says networking to find organisations that share views and banding together to influence companies' activity can be an effective means of helping small organisations make a difference.

Also, charities should not underestimate the authority they can command due to the sector's place in society.

"Charities punch above their weight with their name and reputation," Hoare says. "Their reputation, or their brand if you want to put it like that, actually gets other investors and managers listening to what's being said."

This goes beyond the solutions available or in demand. Mason says there has been real progress in the options available to smaller charities who wish to make their voice heard at a corporate governance level.

Innovation has seen much smaller charities benefit from Church Commissioners' approach of taking on the voting function itself, ensuring engagement is in line with its ethical approach.

"Some smaller church investors thought they would like to do that too. One particular member of the Church Investors Group badgered its manager to have their shares voted in line with church principles - as the CofE and the Methodist churches do. Eventually they got that. So we now have a common voting template that even one of the smaller investors in the Church Investors Group gets in its pooled funds."

But there are risks to be mindful of when separating the investment and engagement function. "When you disconnect that you weaken both halves," Landell-Mills says. "It's a practical issue in the end; of what's easier and most streamlined. But it can be so powerful having it all together."

Social investment

Mason says it would be exciting to see charities look at their investments as an opportunity to advance their mission in a new way, rather than simply as a risk.

SRI approaches such as carefully considered exclusion policies, clear and active engagement, and best practice transparent reporting can help a charity further its mission through finance. But an emerging financial tool is providing an even more direct way to align mission and investment.

Social investment, whereby investments are made in organisations or projects for both a social and financial return, has obvious appeal in that funds that may otherwise have been awarded as grants can be recycled and used again. And capital that may have been allocated solely for a financial return can serve a dual purpose. Ideally, funds set aside for social investment would grow overtime and provide for evermore interventions and generate greater impact.

And there is a will to see this market grow. The Government put weight behind this emerging form of finance when establishing Big Society Capital, a social investment bank funded by dormant accounts and the main high street banks to invest in social investment finance intermediaries.

The Government has also supported the growth of social investment through initiatives such as funding programmes to enable organisations to improve their investment readiness, and offering tax reliefs on social investment.

St John's Hospital has dedicated 5 per cent of its endowment to social investment over the next four to five years. Money-Kyrle says the majority of that will be in direct investment, enabling the charity to use the funds in line with its charitable objects.

He says that social investment has been heralded as having significant potential to do good, but it is still early days and some scepticism remains around the approach.

"The giving relationship is great, but financially it's one way. You tend to have a relationship the majority of the time, depending on the level of funding and then that relationship may close. This investing relationship is a long-term thing, it's not just about the money. That generates a partnership that we have with our investees which I think is quite healthy and important. But it's not a perfect marketplace and we're developing and building it as we go."

But, for various reasons, the market is not there yet.

Lee says Joseph Rowntree Charitable Trust got actively involved with social investment some years ago, carving out around £10m to dedicate to the field. However, the investments proved to be very hard to execute and questions arose over whether it was the most effective use of trustees and staff's time, both a scarce resource.

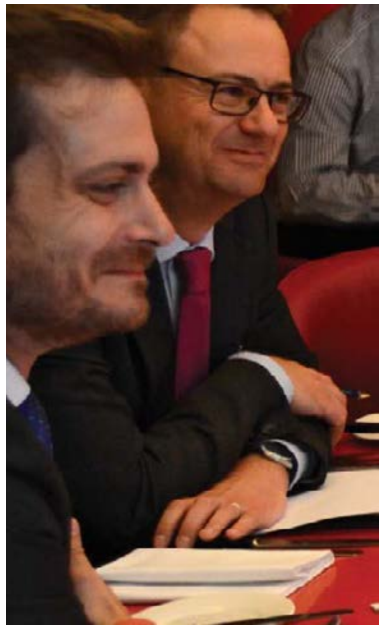
"I think we have an open mind," he says. "As trustees it's the sort of thing we really love to do, but we realise the difficulties, we realise the work, and we wonder if we're really the right people to be doing it."

But, at present, one of the biggest issues is finding a way to match supply up with demand. Large investors may struggle to find opportunities of sufficient size, while the level of understanding in the sector could be acting as a barrier for charities being ready and willing to accept social investment.

"It's one of the few areas where it's harder as a big investor," Mason says, "because we're used to making investments of around £20 million. The impact investment space isn't really mature enough to offer those kind of opportunities for us."

Fund managers were looking at the space, but there remain obstacles to overcome. Finding demand, while there were also challenges on the investment side. Maitland says investors in this space tended to want to allocate to causes or projects that were quite personal to them, limiting the universe.

Education and understanding is also a problem at present, Maitland says. This view is supported by research St John's carried out in Bristol and Bath, which revealed most respondents found the concept of social investment hard to understand and feel they lack



"Charities punch above their weight with their name and reputation"

understanding of the field.

But the will remains to grow the market, Skeates says, and it is hoped it will develop to make an important contribution to civil society.

"There's a lot of creative thinking in this space," she says. "There are lots of things that can be done, including building a broad spectrum of funds with specifically targeted characteristics. But we would love to see the space grow."

Conclusion

Social investment is an emerging area, and if many investors, the Government, and the finance community get their way it has a big future. But, there is plenty to be done within the boundaries of the developed asset classes yet.

One lesson from this panel of experts is that charities will be well served by building on strong foundations. Decide on how your beliefs and objectives should be expressed through your investments right up front, and make that a bedrock of investment decision-making.

Be clear on what you do not want to own, but equally do not hesitate to ensure the assets you do own are being managed in the right way.

This is where communication becomes vital. There were lessons here for charities and their investment managers. There is no lack of intent on either side for open dialogue and exchange of information. In short: trustees should be demanding and managers should be forthcoming. The more the two sides talk, the better tailored the SRI space will be for charity clients.

Maitland says: "We've certainly found that the more we have published on this, the more we put in our reports, the more we engage with our clients, it allows the feedback to us and you get into a virtuous circle – that the more you do the more clients are interested in it, and the more they feel able to comment."

Finally, it is an area the sector can work together on. Sharing information, working together to effect change for the better. Charities are often told they will achieve more towards fulfilling their objectives by cooperating. It would seem the responsible investment space is no different.

"There are some charities with a very specific or narrow mission, some are geographically restricted and some are subject restricted," Hoare said. "But you can find other people who share enough to be able to take steps to say: 'we want to engage on this question because it affects this issue that we're interested in'. We can take action to enhance our mission, and to enhance our investments, by taking an ethical and responsible approach to investing."