

EIRIS Foundation response to Charity Commission call for views on Responsible Investment

The EIRIS Foundation is pleased to respond to the Charity Commission's call for views on how charities approach investing in line with their purpose and values.

According to their request for feedback as outlined in their blog post on the 15th of January the Charity Commission are looking for answers to the following questions:

'What are your experiences and current considerations around responsible investments? What do you think are the barriers to more widespread responsible investments and what more could be done to support trustees to invest in a way that reflects the charity's purpose and values?'

About the EIRIS Foundation:

The EIRIS Foundation is a charity registered in England and Wales working in the area of responsible investment. The Foundation has over 30 years' experience of providing free and objective information on ethical finance and corporate activity to other charities and the public.

Our mission is to use research, analysis and influence to identify gaps, barriers, opportunities and enablers so that we can help organisations and individuals maximise their contribution to the responsible business and investment agenda.

We strongly believe that charities have an influential role to play in shaping a more sustainable financial system. By ensuring they are investing and saving responsibly and in harmony with their mission and values charities can reap significant mission-related, reputational and financial benefits while complementing the voluntary sector's fundamental objective of building a fairer society and achieving the Sustainable Development Goals. For more information please visit: www.eirisfoundation.org.

Our response

We acknowledge that current guidance doesn't prohibit charities from taking social, ethical and/or environmental considerations into account with regards to their investments, however, it also does little to encourage them and indeed, it is our belief that charities **should** be taking their charitable objectives and their public benefit requirement into account when setting investment policy and making investment decisions.

The present guidance gives too many trustees the impression that aligning your investments with your mission is fairly optional (and rather complicated) with the result that all too few charities have clear policies, clear allocation of responsibility for implementation and clear communication with their investment managers.

The risks to the sector, and to public confidence in charities more generally are two-fold: firstly those who support charities can be unpleasantly surprised by revelations that a particular charity has "done the wrong thing" with its investments, and secondly (and perhaps more importantly) that valuable opportunities to advance charitable causes are being missed as responsible investment and corporate responsibility increasingly focus on issues directly related to many charitable missions.

Experiences and current considerations

Our experience, through contact with numerous charities and foundations, has been that there is a growing desire amongst charity staff and trustees to better align their investments and their mission. Although there are a number of charities who are pioneers and leaders in this area there are still many who either haven't gone through a robust process (if any) or who feel that they haven't fully explored their options and still have more to do. Despite research and evidence to the contrary, there is still some concern that applying responsible investment criteria and/or policies may be detrimental to returns and some charity staff and trustees are confused about how much to prioritise 'non-financial' issues and risks.

Current guidance is not in line with developments in this space and with changes that have been implemented with regards to pensions. In October 2019 new regulations came into force clarifying and strengthening pension scheme trustees' environmental, social and governance responsibilities. Pension Funds' Statement of Investment Principles (SIP), basically a scheme's investment strategy, must now include the trustees' policies on:

- financially material considerations including environmental, social and governance matters such as climate change
- stewardship of investments, such as exercising rights (including voting rights) and engaging with activities in respect to the investments
- the extent to which members' views, including ethical, social and environmental, are considered when planning investments
- arrangements with asset managers

Considering that it could be argued that the public benefit requirement for charities gave them just as strong a mandate for considering issues such as climate change, if not even stronger, why do charities not have a similar sort of requirement?

The EIRIS Foundation is a part of the coalition of charities which has called on the Charity Commission and Attorney General to seek a landmark ruling on whether and how charities should align their investments with their objects and their duty to provide public benefit. The coalition has argued that existing guidance is outdated and doesn't sufficiently consider the current landscape of environmental and social issues and particularly climate change. Broadly we are supportive of the Coalition's belief that it is in the Charity Commission and wider charity sector's interests to permit the parties to seek declarations about the nature of the law on charity investment, so that clarity about what the law permits is obtained and trustees are empowered to invest accordingly. We are also strongly of the view that while we believe trustees should be empowered to invest in ways which are aligned with objects and values, updated guidance should not prescribe exactly how this should be done. Different organisations will have different approaches to responsible investment and trustees should have discretion to determine what is in the interests of their respective charities.

Our research has found that there are still many, including large charities, who have NO responsible investment policy at all, or a very basic 'no tobacco' screen. This is potentially problematic for numerous reasons, but particularly reputational risk, financial risk and the risk that the charity's investments undermine its mission and charitable objects.

Barriers

A key barrier to more charities investing in line with their values and mission is confusion around trustee duties in this area, particularly around the requirement to maximise financial returns and a perceived potential conflict between that and responsible investment considerations.

Another barrier we have discovered when having more in-depth conversations with trustees and charity staff is the lack of practical, detailed advice about responsible investment and the variety of options available. Trustees sometimes feel that they lack expertise in this area when it comes to making more difficult decisions that can involve trade-offs or compromises. There may be a clear policy, but how to put that into practice can be less clear.

Other barriers include a lack of options; a lack of support from investment managers /advisors; and the difficulty of developing a credible screening policy particularly when the discussion seems to raise complex ethical issues on which views may differ.

The present guidance is particularly focussed on when a charity may be justified or required to avoid certain investments, or by when it can commit funds to an investment with mixed motives.

Both assume that the trustees are in a position to make investment decisions at the level of individual holdings, and so to making individual judgements about whether particular stocks should or can be avoided.

However, in practice most charities (and almost all smaller ones) will be investing in mutual funds or buying into strategies that fund managers have created for multiple clients, albeit sometimes with the option of some tailoring for larger charities. In these cases their key choices will be which wealth manager or charity specialist can take responsibility for their whole portfolio (and then considering any choices that such a manager is able to offer them), or which financial adviser do they trust to assemble a portfolio of funds for them and how they wish to be involved in the approval of individual funds.

On the one hand, charities and their managers need to be careful that by investing in funds rather than directly into shares or bonds, their portfolio does not end up investing in assets they wish to avoid. A number of charities have faced problems here over the years, and there needs to be a high level of transparency by managers managing charity investment to avoid unpleasant surprises.

But on the other hand, it is not clear how a trustee should proceed faced with a fund that meets their screening criteria, but which also goes beyond what the trustees would impose if they were choosing the individual stocks themselves according to the present guidance. The loss of diversification from such restrictions may have a very minor financial impact. Some restrictions may have been adopted in whole or in part by the manager in pursuit of sustainable long-term returns and the fund or strategy may have a range of positive benefits to the charity's mission (a focus on companies with strong environmental or social purposes, engagement with companies to improve their impacts in areas of relevance to the charities purpose and so forth).

For charity asset managers the same challenge applies in reverse: if they offer pooled funds or strategies that meet the exclusion requirements of a range of charitable clients, will they find some are unable to justify all the restrictions on a strict application of the various caveats and factors to be considered in the present guidance. So the economies of pooled products that they sought to create may be undone.

What more could be done?

The public benefit test

The public benefit requirements were not in force for charities in the same way at the time of the Bishop of Oxford case which has underpinned significant parts of the Commissions guidance to date. Those requirements now state that charities should carry out their work in ways that do not harm the charity's beneficiaries or the public in general. It is certainly possible that the companies in which a charity invests to help fund their work could be doing either or both. It would be helpful to give clear guidance on how the public benefit test applies to investment activities, including in relation to the further requirement to ensure that any harm is a minor consequence of the way the charity is operating. The options that trustees have in this field have developed significantly, particularly with the development of responsible investment in the last 10 years.

New guidance could clarify:

1. Whether charities discharge the "identify and minimise harms" requirement by pursuing engagement with investments identified as doing harm (directly or via their fund manager)? This might helpfully be aligned with the OECD's principles on Responsible Business Conduct for Institutional Investors.
2. Whether the "minor consequence" requirement mean that trustees should at least assess the harms associated with investment strategies having similar anticipated returns, with a view to finding the least harmful? And can they balance any identified public benefits achieved by investments against harms done as well?
3. The concept of public benefit isn't specific to the charity's own purposes: does this mean that trustees should increasingly be cautious about investments which conflict with the purposes of other charities as well as their own when it comes to applying the public benefit test in this area?

How should new guidance encourage and support trustees?

The general aim should be to make it simpler for trustees and to protect charities who have done their best.

They should be encouraged to consider and where appropriate engage in dialogue with stakeholders and advisers about:

- a. the ways in which the companies and other entities in which they may invest have positive or negative impacts that relate to their charitable purpose.
- b. the ways in which their investment approach may influence their donors, their staff, volunteers, any partner organisations and their wider public reputation.
- c. the ways in which responsible investment has been developing that could offer new opportunities to advance their mission

From these considerations, they should draw up their ethical investment policy clarifying what they see as necessary or desirable in terms of the responsible investment strategies now available (positive screening, negative screening, engagement activity, tilted indexes and so forth).

Then, as long as they have ensured that any exclusions they have decided are necessary are being followed, they should be free and encouraged to choose between investment strategies and funds solely on the basis of an overall judgement of what does the most for their charity given its particular mission and circumstances and taking into account the balance of responsible investment impact, anticipated investment returns and the costs and charges involved.

That sort of “big picture” guidance would leave trustees free and encouraged to take full advantage of the potential for responsible investment to advance their mission and to strengthen and protect their organisations.

Charity managers obligations

It would help to ensure good communication if those who manage charity funds had a responsibility to the “know their clients” with some degree of responsibility to ensure that the investments they make are suitable for the charity concerned. This should primarily be a duty to follow any ethical investment policy adopted by the trustees, but also to draw to their attention to any areas of potential conflict (for example investments in a mutual fund portfolio that are not aligned with exclusions the trustees have decided upon). But secondly, if no ethical investment policy has been drawn up by the trustees or made available to the manager, they should have a duty to find out which of the 13 general charitable purposes apply to the charity and to ask questions about the trustees requirements related to those purposes.

Other steps the Commission and others can take

Aside from the need for formal guidance and clarity around duties and requirements as already mentioned, there is also more the Commission could do to support charities in this area. There are organisations providing support and resources for charities that we recommend the Commission consult and work with going forward, including ourselves. Existing resources need to be highlighted and new resources can be tailored to ensure that charities are receiving the practical help they need. We ourselves are in the process of developing our support for charities in this area. Responsible investment has sometimes been considered an issue for only the larger charities, those with considerable amounts of investable capital. However, increasingly charities of all sizes have begun to think of how their choice of all financial providers can be aligned with their charitable objectives and values. The EIRIS Foundation has recently developed a new tool for charities to help them do this. The Charity Ethical Money Action Plan is intended to help charities and foundations navigate the process of establishing and implementing policies and processes which helps them to consider not only responsible investment of their own assets but also all aspects of their money and their influence on the financial sector.

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

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

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

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

Partnerships – Do your partnerships, both with corporates and others, align with your values and ethics and help to further your overall mission and charitable purpose?

We aim to develop resources around each of these aspects in order to help provide charities with practical help.

The responsible investment and sustainability landscape is developing rapidly. New products and new best practices are emerging and it is important that whatever actions the Charity Commission takes going forward, whether this is updated guidance or more help in some other form, it takes into account the potential for change and future innovation.