Investing Responsibly

A practical introduction for charity trustees

Foreword

Trustees have many important responsibilities - none more so than deciding how and where to invest their organisation's assets. NCVO is therefore delighted to be jointly publishing this practical toolkit on Responsible Investment with EIRIS and UKSIF. Responsible Investment has been steadily growing in importance over the last few years and NCVO welcomes the publication of this toolkit to both reinforce that significance and to slay some of the myths that have grown up around Responsible Investment.

By introducing the options available to trustees and providing a step-by-step guide to devising and implementing a Responsible Investment policy, this toolkit will prove indispensable to those trustees who are embarking on or who wish to update their organisation's Responsible Investment strategy.

I strongly believe that through investing responsibly, trustees can only strengthen the voluntary and community sector, through implementing polices that complement its fundamental objective of building a fairer society.

Stuart Etherington – Chief Executive of NCVO

What is Responsible Investment?

Responsible Investment is about aligning a charity's investments with its objects. It is based on achieving the greatest impact from investments by both pursuing maximum financial return and using investments for non-financial gain.

There is no single model to Responsible Investment. Rather there are three approaches that can be combined in different ways:

- **SUPPORT - or positive screening - involves investing in companies with a commitment to responsible business practices, positive products and/or services. This approach comes in a number of forms including best-in-class (investing in companies with the best practice in their industry) and thematic investment (e.g. an environment charity investing in environmental technologies)**
- **AVOIDANCE - or negative screening - is the most commonly recognised form of Responsible Investment. Avoidance means not investing in companies that do not meet the ethical criteria that the charity sets**
- **ENGAGEMENT - or shareholder activism - is using the influence of investors and the rights of ownership to encourage more responsible business practice. This might not alter stock selection and mainly takes the form of dialogue between investors and companies. It may extend to voting practices.**

[1] *The term Responsible Investment incorporates both ethical and socially responsible investment (SRI).*

Is Responsible Investment allowed?

The simple answer is yes, within certain bounds. Trustees are required to maximise return on investment. The Charity Commission[2] recognises that 'an ethical investment policy may be entirely consistent with this'.

The Charity Commission provides no specific guidance on a support approach. With avoidance, it recognises three situations where the investment strategy can be governed by considerations other than level of investment return. These are where:

- **investment in a particular type of business would conflict with the charity's aims**
- **an investment might hamper its work, either by making potential beneficiaries unwilling to be helped because of the source of the charity's money, or by alienating supporters**
- **even if an investment does not come into either of the previous two categories, trustees can accommodate the views of those who consider it to be inappropriate on moral grounds, provided that they are satisfied that this would not involve 'a risk of significant financial detriment'.**

With engagement, the Commission recognises that a charity may wish to influence a company both to ensure that its business is conducted in the charity's best financial interests and that its business does not conflict with the Responsible Investment policy.

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Save the Children (SC) UK

SC UK's Responsible Investment policy fits within its overall stance in relation to the UN Convention on the Rights of the Child 1989. SC UK will not invest in companies whose activities they judge to be against the interests of children, or whose objects conflict with theirs. The policy also states that investments should not alienate supporters or beneficiaries.

Why should my charity consider Responsible Investment?

As charities are value-led organisations, trustees often decide that investment choices should be consistent with the charity's objects. To do so, they ensure that investments complement rather than counter the charity's work. Before deciding on an investment, some children's charities assess whether the company's activities have a detrimental impact on children, e.g. child labour practices or pornography.

The three approaches to Responsible Investment help a variety of charities ensure consistency between their objects and investments. Cancer and other medical charities often avoid tobacco-related investments. Some human rights charities have used an engagement approach to discuss with a company its involvement in a specific country.

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Allen Lane Foundation

The Foundation funds work which benefits unpopular groups and makes a lasting difference to people's lives with a focus on reducing isolation and discrimination. The trustees avoid investing the endowment in ways they believe would counter the charity's work. They work with their fund manager on the policy, which currently excludes armaments and tobacco.

Charities have also adopted Responsible Investment for risk management purposes. A key asset of charities, particularly fundraising charities, is their reputation and adopting Responsible Investment may boost public perception, prevent negative publicity and match donor expectations[3]. For example, donors to an animal welfare charity may expect that there is a policy with regard to investing in companies that undertake animal testing.

[2] 'CC14: Investment of Charitable Funds' (February 2003), www.charitycommission.gov.uk.
[3] Over 40% of respondents to a 2001 NOP Survey for Charities Aid Foundation preferred to support charities that invest ethically. Details of the survey at www.cafonline.org.

>> British Ecological Society (BES)

BES is a membership organisation whose core activities are publishing research, organising meetings and promoting awareness of the science of ecology through education. BES seeks to invest in companies that perform better in environmental terms. This includes considering companies' environmental policy and practice and the impact of their products.

In considering Responsible Investment, what factors should I be thinking about?

Trustees must ensure that any Responsible Investment policy is appropriate to the charity's circumstances. This includes considering whether the policy fits with regulatory guidance, is proportionate in terms of time and cost and is the right strategy to achieve the charity's stated aims (both programmatic and financial).

>> Royal Society for the Protection of Birds (RSPB)

RSPB invests in accordance with its principles, whilst not losing sight of the responsibility to maximise funds available for bird conservation and the environment. Its focus is on activities in direct conflict with its objectives or likely to be of concern to its supporters (e.g. animal testing). To achieve this, RSPB has adopted a combined strategy of avoiding some companies, support (through a pooled fund) and direct engagement with a small number of selected organisations.

The charity's size and investment approach are crucial. If a charity has sufficient investment assets to allow for a segregated approach its options differ from those for charities who invest through pooled funds[4]. Larger charities may also have a capacity to run their own engagement policy or to work pro-actively with fund managers.

>> Responsible Investment and non-equity investments

Responsible Investment options for fixed interest, cash, and alternative asset classes are increasingly being offered. For example, corporate bond funds that only invest in companies addressing global concerns around sustainable development have been established. There are also property and hedge funds and interest-bearing cash deposit accounts with Responsible Investment criteria. For Islamic charities, Shar'ia compliant products have been developed.

The nature of a charity and its activities should also be factored in. For membership charities, trustees may have to consider members' attitudes on whether investment decisions should reflect the charity's values.

Collaboration may make Responsible Investment more effective. If trustees share knowledge, pool funds or engage jointly with others in their field, obstacles to success may be overcome. One collaborative option could be for charities to engage jointly to maximise their influence on companies (and to share costs).

>> Examples of faith-based collaboration: ECCR and Church Investors Group

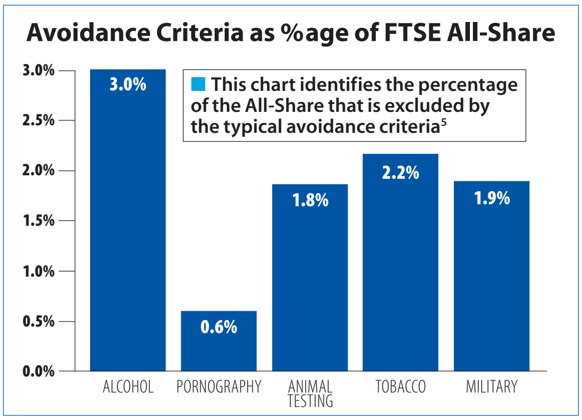
- **ECCR (Ecumenical Council for Corporate Responsibility) was formed in 1989 to raise the profile of corporate responsibility within the churches. It is a meeting point for faith communities to work, research and learn.**
- **The Church Investors Group is an initiative between 11 major church bodies. It is a framework for developing a common understanding of the ethical issues affecting companies and provides an opportunity for them to collaborate on engagement.**

[4]*Pooled funds, including Common Investment Funds (CIFs) can provide various Responsible Investment options using support, avoidance and engagement criteria.*

Concerns about performance

Traditionally, trustees have been concerned that Responsible Investment performs less well than conventional funds (a fear that avoidance impacts performance as it reduces the choice of investments). However with 20 years of actual performance, these concerns appear to be lessening. Moreover, Responsible Investment may bring an information advantage through its focus on materially important issues that are often overlooked. Considering issues such as brand values and corporate governance helps to show investors how a company behaves and may allow them to spot opportunities and avoid investments which could run into serious trouble.

With avoidance, the choice is not simply whether to exclude all companies involved in an industry. A measured approach can be taken with materiality levels and actual activity considered. For example most charities that avoid tobacco investments tend not to avoid all companies that sell tobacco (e.g. supermarkets). Rather, they set a materiality level, avoiding only companies who derive for instance, over 10% of sales from tobacco or companies whose main product is tobacco (as in the chart).



>> Reported research on performance of Responsible Investment screen ed funds

- **The Investment Management Association found that over the period 1993-2003, ethical funds performed more or less on a par with their non-ethical equivalents.**
- **A report by WestLB Panmure, 'More Gain Than Pain' (November 2002) commented that there was: 'no sign of a systematic performance disadvantage'.**
- **In its 2004 report 'Risks, Returns and Responsibility', the Association of British Insurers stated that 'incorporating social responsibility can reduce portfolio volatility and increase returns'.**

Trustees are rightly concerned about maximising (risk-adjusted) financial returns. Research on the performance of Responsible Investment funds suggests that whilst they may perform differently[6], some have performed as well as conventional funds. As with all investments the key issue here is active fund management (all active fund managers screen out stock for various reasons): over the longer term, performance is primarily a function of fund management skill. This consideration substantially differs from saying that investing responsibly leads to poor performance.

>> Case studies on performance

- **The Church Commissioners investments' performance has exceeded their independent bench mark (WM All Funds universe for UK pension funds). From 1994-2003 total return has averaged 10.2% compared to the benchmark's 6.4%. These results have been achieved with a policy meaning that approximately 9% of the FTSE All-Share is avoided.**
- **The Joseph Rowntree Charitable Trust's policy is to invest in ways compatible with its Quaker roots and grant-making. The result is that about one-third of the FTSE All-Share is avoided (a level far higher than most charities). Its investment performance for UK equities from 1978-2002 is in line with the All-Share.**

[5]The avoidance criteria used for alcohol is companies with over 10% turnover from sales or production. For pornography it is the provision of adult entertainment. For animal testing it is testing cosmetics on animals. For military it is over 10% of turnover from military sales. Levels of avoidance vary between charities and the criteria used above are illustrative (Source EIRIS as at 01.03.05).

[6]Typically, avoidance and support policies result in investors holding a larger proportion of shares in small to medium sized companies, compared to conventional investors.

Steps to take Responsible Investment forward

Below are some steps to consider when taking Responsible Investment forward.

Step One: review and fact find

Review the charity's current position and resources. Factors to be reviewed include:

- the current investment assets and where they are invested
- whether the charity's governing document includes any restrictions
- the expertise available and what competencies current fund managers can offer
- what other charities (especially peers) are doing.

>> Review and fact find checklist

- **Review all relevant factors – financial and non-financial**
- **Check legal position**
- **Decide on what additional information is required and how it can be obtained**

Step Two: set aims

Setting aims is about moving from a point of interest in Responsible Investment to clarifying why the charity should invest responsibly and what it should seek to achieve from doing so. It may be at this stage that the trustees decide it is inappropriate for the charity to implement Responsible Investment.

Trustees should articulate the motivations for adopting Responsible Investment and consider how it links to the charity's objects, strategy, investment approach and risk assessment. By articulating the above, aims can be set and how value can be added defined. Trustees may wish to consult with the charity's stakeholders.

>> Set aims checklist

- **Be able to explain why the charity is adopting Responsible Investment**
- **Be able to articulate the aims set for Responsible Investment**
- **Consult with beneficiaries and stakeholders**

Step Three: agree policy

An optimal policy builds on steps one and two to prioritise and plot a course forward.

Content

Initial research on the content of the policy can help trustees clarify which issues to focus on and the implications of different approaches. For example research can show how many of the companies that the charity currently invests in would be avoided and how setting levels of materiality or specific criteria changes this. To illustrate, if a charity for religious reasons considers avoiding investments in the armaments industry it will want to balance beliefs with continued good financial returns (not avoiding too many companies). The charity may therefore decide to only avoid companies whose main business is armaments. This could be achieved by setting a materiality level on turnover or by distinguishing between companies by the nature of their products. Alternatively, if the charity is considering a support approach, relevant investment opportunities will need to be identified.

Style

Charities that adopt Responsible Investment tend to start from one of three styles:

- **One style starts with deciding which of the approaches (support, avoidance and/or engagement) to employ and works forward from that point**
- **The second style is thematic. It is a comprehensive option based on ensuring that investments are compatible with objects. Policy is determined by agreeing the charity's concerns/themes and assessing how policy can best reflect them**
- **The third style focuses on the charity's existing investment portfolio. Policy is developed through a focus on the companies in, and the overall look of, the investment portfolio. It may include engagement with these companies or the decision to divest or increase the charity's holdings in some of them.**

Which approach to take?

Will be influenced both by the aims set for Responsible Investment and practical considerations. For example a fund-raising charity with narrow objects, e.g. animal welfare, may decide that an avoidance approach is appropriate because it fits with its objects, manages reputational risk and is cost-effective. The business case for companies taking environmental risks seriously may make engagement attractive for a large endowed charity. A support approach where the portfolio is biased towards companies in sectors the charity believes to be beneficial may also fit its aims.

Resources

Clarify what resources are available for Responsible Investment. By considering resource constraints, any policy is more likely to be proportionate and appropriate.

The end result of this stage should be a written policy.

>> Agree policy checklist

- **Identify any investments which directly contradict the charity's objects**
- **Decide if there are other investments you would be keen to avoid. Give clear reasons and find a sufficient range of viable financial alternatives**
- **Be aware of how many companies will be excluded from the portfolio**
- **Identify any investments you would like to promote as positively furthering the objects of the charity and decide if they are financially justifiable**
- **Be aware of the possibilities and resources required for engagement**
- **Decide on style of policy and agree resource allocation**
- **Consider how Responsible Investment affects the overall investment policy**
- **Produce a written policy document which lays out aims, content and focus**

Step Four: implement policy

For trustees, the implementation stage is about ensuring the Responsible Investment policy is carried out and that the aims set for it are achieved.

>> The role and responsibilities of trustees

The role and responsibilities of trustees regarding Responsible Investment includes

- **Deciding on the aims of the policy and what resources are required**
- **Ensuring compliance with the charity's governing document and legal and reporting requirements**
- **Signing-off the Responsible Investment policy**
- **Agreeing implementation strategy and appointing managers and advisers**
- **Monitoring the implementation and impact of the policy**

The Charity Commission advises that 'Trustees are unlikely to be criticised for adopting a particular policy if they have considered the correct issues, taken appropriate advice and reached a rational result'.

As implementation is often delegated to staff and fund managers it is crucial that trustees take time to explain the policy. In determining the best implementation strategy trustees need to ascertain whether the existing services provided by fund managers are sufficient or whether additional expertise is required. A key part of this process is producing a series of questions for fund managers.

>> Questions to ask fund managers

- **What Responsible Investment services do they provide?**
- **Do they engage with companies (if so which ones and on what issues).**
  Are they able to exercise voting rights in accordance with trustees' instructions?
- **What resources do they employ for research and engagement?**
- **Do they charge an additional fee for a Responsible Investment service?**
- **How do they incorporate social, environmental and ethical matters into their risk management framework and investment process?**
- **How do they assess and report their Responsible Investment performance?**

Integrating the Responsible Investment policy within the charity's overall investment framework, may minimise costs and make implementation more effective. For example, the fund manager may have implemented Responsible Investment for other clients whilst maintaining the same level of investment return and fee structure. If the Responsible Investment policy is included in the mandate communicated to fund managers, your intentions will be clear and your policy will work with your overall investment strategy.

There are a number of different ways for each approach to Responsible Investment to be implemented. For example, with engagement the easiest option may be to use a fund manager with an active engagement process. Alternatively you may decide it is best for the charity to engage by itself or in collaboration with others.

>> Implement policy checklist

- **Identify who the policy should be communicated to**
- **Clarify the role of the trustee body, sub-committees, staff and advisers**
- **Determine the best implementation strategy for the approach(es) adopted**
- **Ensure that clear instructions have been delegated to the fund manager**

Step Five: report and review

With clearly defined aims and a written policy that is well researched and effectively transmitted, the charity is likely to gain from Responsible Investment.

>> Some questions to help check that the written policy is comprehensive

- **Which assets will it apply to?**
- **How will it affect the choice of companies invested in?**
- **How will it affect the use of voting rights and other forms of engagement?**
- **What is hoped to be achieved from the policy? How will this be assessed?**
- **Who will implement the policy and what services will be employed?**
- **Who will be responsible for implementing the policy?**
- **Who needs to know about or contribute to the policy?**

An effective and on-going monitoring process should be established. It should include an assessment of the impact of Responsible Investment and whether it has achieved its aims. Underlying this should be an assessment of a number of factors including: the performance of fund managers; costs; which approach best suited the charity; and whether the key issues were addressed.

Reporting on the policy and its impact presents an opportunity for charities. For charities with reputational risk concerns or where stakeholder consultation occurred, reporting may bolster image. The revised reporting standards for charities, SORP 2005 require that trustees report on 'the extent (if any) to which social, environmental or ethical considerations are taken into account' within the investment policy[7].

>> Report and review checklist

- **Decide on criteria through which trustees will assess and review the policy**
- **Decide whether those delegated to have performed as mandated**
- **Determine whether Responsible Investment has achieved its aims and, if not, identify the reasons and where improvements can be made**
- **Ensure that the policy and its impact is reported on to relevant stakeholders**
- **Ensure that the SORP reporting requirements are met**

[7] *At paragraph 55(d) of the SORP 2005, www.charitycommission.gov.uk.*

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