CHARITY SRI Helping charities invest responsibly

Socially Responsible Investment

A practical introduction for charity trustees

November 2011

Foreword

Trustees have many important responsibilities - perhaps none more so than deciding how and where to invest their organisation's assets. CFDG is therefore delighted to be jointly publishing this practical toolkit on Socially Responsible Investment (SRI) with the EIRIS Foundation.

Recent years have seen finance, and especially the dangers of an irresponsible approach to finance, placed centre stage. Within this period we have also seen public expectations around charities' approach to SRI increase. A 2011 survey conducted by EIRIS Foundation and the Holly Hill Charitable Trust found that 78% of the UK public would think worse of a charity if they found out it had funds invested in activities that run contrary to its specific work and values; 74% of people agreed that large charities should adopt ethical investment policies prohibiting investment in activities that are contrary to their specific work and values; and 84% of people agreed that charities should be fully transparent about their investments

We strongly believe that investing responsibly is a positive forward-looking strategy for charity investment that can reap significant mission-related, reputational and even financial benefits while complementing the voluntary sector's fundamental objective of building a fairer society.

By introducing the issues and providing a step-by-step guide to devising and implementing a socially responsible investment policy, this toolkit will prove indispensable to trustees embarking on or wishing to update their organisation's SRI strategy.

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What this guide covers

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1 What is socially responsible investment?

Socially Responsible Investment (SRI), sometimes also referred to as responsible or ethical investment, is about taking steps to ensure that a charity's investments reflect its values and ethos and do not run counter to its aims.

It describes an investment approach that takes environmental, social, ethical and governance (ESG) factors into consideration in investment decisions. It is based on achieving the greatest impact from investments for charities by both pursuing maximum financial return and ensuring investments complement rather than undermine the wider aims of the charity. Ensuring that financially material ESG issues have been considered in decisions is also a prudent decision for long term investors.

There is no one-size-fits-all model to Responsible Investment. Rather there are a number of approaches that can be used separately or in combination.

- **Positive Screening: involves positively selecting companies for investment that have a commitment to responsible business practices and/or that produce positive products or services. This approach could take a number of forms including for example selecting companies for investment that produce products that help to combat climate change such as technology for renewable energy generation. Positive screening could also take a best-in-class approach. This means excluding only a few sectors but, within each sector selecting only the best performers on a range of criteria such as their record on human rights or pollution.**
- **Negative screening: involves avoiding investing in companies or sectors that do not meet the ethical criteria that the charity has set. An example may be a health charity not wishing to invest in the tobacco industry.**
- **Engagement: or shareholder activism - is using the influence and rights of ownership to encourage more responsible business practices. This mainly takes the form of dialogue between investors, or their fund managers and companies however it can also extend to using voting rights to enact change.**
- **Other financial services: SRI can also be applied to other types of investments and financial services.**

For example, SRI can help charities to ensure the money held in an occupational pension scheme, insurance policies, current accounts or corporate credit cards has the most positive impact.

The approach taken will depend on a range of factors including resources available, the size of investments and the objectives of the charity.

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2 Is socially responsible investment allowed?

The simple answer is yes, within certain boundaries. As in all areas, trustees are required to make investment decisions based on what is in the best interests of the charity.

The Charity Commission's investment guidelines 'Charities and Investment matters' (CC14) states that trustees of any charity can decide to invest in a socially responsible or ethical way, 'even if the investment might provide a lower rate of return than an alternative investment. However, a charity's trustees must be able to justify why it is in the charity's best interests to invest in this way.'

The law allows the following reasons:

- a particular investment conflicts with the aims of the charity; or
- the charity might lose supporters or beneficiaries if it does not invest ethically; or
- there is no significant financial detriment.

So any decision trustees take about adopting an ethical investment approach must be justified within one or more of these criteria. Trustees must be clear about the reasons why certain companies or sectors are excluded or included. They should also evaluate the effect of any proposed policy on potential investment returns and balance any risk of lower returns against the risk of alienating support or damage to reputation. This cannot be an exact calculation but trustees will have to assess the risk to their charity.

The Commissions guidance also states that 'if trustees have considered the relevant issues, taken advice where appropriate and reached a reasonable decision, they are unlikely to be criticised for their decisions or adopting a particular investment policy.'
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 charities' Responsible Investment policy.

3 Why should my charity consider socially responsible investment?

There are three key reasons why it may be important for your charity to adopt socially responsible investment.

3.1 To support charitable mission

As value-led organisations, it is crucial for charities to seek to further their mission in every area of their operations. Corporate behaviour can have a significant impact on major issues of charity concern such as climate change, access to basic services and human rights. Therefore where a charity invests its assets is an area that is particularly important not to ignore. SRI enables charities to ensure that their investments do not undermine their work and can potentially extend the positive impact that the charity has.

The three approaches to SRI described above can help a variety of charities to ensure consistency between their investments and mission. For instance a children's charity may want to ensure that it does not support a company with activities that have a detrimental impact on children; for example those found to market alcohol products irresponsibly. An environmental charity may feel that investing some of its money in companies producing renewable energy products complements the campaigning work that it does around climate change.

A human rights charity may wish to use its rights as a shareholder, as well as its status as a respected voice on human rights issues to engage with companies on their involvement in a specific country.

3.2 To safeguard reputation

Charities have also adopted SRI for risk management purposes. A key asset of charities, particularly fundraising charities, is their reputation. Adopting SRI may boost public perception, prevent negative publicity and match stakeholder expectations. Charity employees may be less motivated to work for a charity whose investments undermine their work and donors may be less likely to support a charity. Research by the EIRIS Foundation and GFK NOP in 2009 found that 86% of the UK public were less likely to support a charity that did not invest responsibly[1].

3.3 For prudent long-term investment

SRI strategies are also a professional response to trustees' investment duties. An increasing body of research suggests that considering the ESG aspects of companies can also help to mitigate financially material risk through providing a more detailed picture of the future performance of an investment, especially over the long term[2].

Tudor Trust

The Tudor Trust's investment principles aim to ensure that its investments promote the mission of the trust, to support the social, economic and financial needs of people on the margins of society, rather than frustrate it. As the trust considers itself to be a long term social investor in ameliorating society's ills, it believes its financial investment should look for long term rather than short term performance.

[1] GFK NOP poll of 2,000 UK adults carried out in 2008 for the EIRIS Foundation, see www.eiris.org/files/press%20releases/charitysrisurveyaug2008.pdf

[2] Fiduciary Responsibility (UNEPFI, 2009), states: "in conclusion, we believe that the global economy has now reached the point where ESG issues are a critical consideration for all institutional investors and their agents." www.unepfi.org/fileadmin/documents/fiduciary11.pdf , p.11 UNEPFI (2009). See also below studies: ECCE, (2008), UNEPFI, (2007) and ABI (2004)

4 Addressing concerns about performance

One of the most common concerns about SRI is that a SRI strategy can lead to lower returns. However, 25 years of actual performance as well as numerous studies have shown little evidence of this. Moreover, studies have repeatedly demonstrated that SRI may bring an advantage through its focus on financially material issues. SRI's focus on sustainability may also make it an appropriate strategy for long-term investors.

4.1 Important studies include:

- The European Centre for Corporate Engagement (ECCE) (2008) conducted a meta analysis of studies on SRI and financial returns and found that "even though they do not present irrefutable evidence that SRI generates higher returns than 'normal' investments, most studies have found that they do not result in worse performance either, while, at the same time, they might actually decrease risk exposure."[3]
- A 2007 report from UNEPFI and Mercer Global Consulting reviewed 20 academic studies, from 1995 to 2006 and concluded that there, "does not appear to be a performance penalty from taking wider factors into account in the investment management process"[4]
- 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'.[5]

Trustees are rightly concerned about maximising financial returns. Research on the performance of SRI funds suggests that whilst they may perform differently, some have performed as well as or better than conventional funds. As with all investments over the longer term, performance is primarily a function of fund management skill as all active fund managers screen out stock for various reasons. Skilful ethical fund managers should ensure that balance is maintained in a screened portfolio through choosing alternative stocks with similar growth opportunities.

The Joseph Rowntree Charitable Trust

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). Between 2000 and 2009 the fund has outperformed or equalled its benchmark, the FTSE All Share Index, in seven out of the nine years.

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[3] Use of Extra-Financial Information by Research Analysts and Investment Managers (European Centre for Corporate Engagement, 2008) http://www.corporate-engagement.com/

[4] Demystifying Responsible Investment Performance (UNEPFI, 2007) http://www.unepfi.org/fileadmin/documents/Demystifying_Responsible_Investment_Performance_01.pdf , p. 7.

[5] Risks, Returns and Responsibility (ABI 2004) http://www.abi.org.uk/Publications/Risk_Return_and_Responsibility_1.aspx , p. 1.

5 Steps to take socially responsible investment forward

There is a large amount of expertise on SRI in the charity sector. Finance directors and trustees that may have previously been through this process can be a valuable resource on this subject. A wide range of resources are available at www.charitysri.org including guides on different investment options, information on the types of issues your charity may wish to consider as well as the latest news and research on SRI.

Below are steps to consider when taking SRI forward.

1. **Clarify current situation**
2. **Get SRI on the agenda**
3. **Set aims**
4. **Develop, expand or update your SRI policy**
5. **Implement your SRI policy**
6. **Review and report**

Step One: Clarify Current Situation

Gather together the information needed to be able to review the charity's starting point, address concerns within the organisation and to be able to suggest how best to proceed.

Factors to think about include:

1. What are the sizes of investments and where are they currently invested?
2. What is the current investment policy?
3. Do the charity's own governing documents include any restrictions on investment policy?
4. What agreements are in place currently with investment managers?
5. What resources, including time and expertise, are available to develop and implement an SRI policy?
6. What are other charities doing? Case studies of other charities are available on the charitysri.org website
7. Who is available and best placed within the organisation to take this work forward?

This research should help you to answer the initial questions from trustees and other decision makers such as: What will SRI involve? Are we allowed to do it? Where are we now?

Review and fact find checklist

Gather all relevant information on the charity's current investment policy	
Ensure that you have clarified what resources are available for SRI including time, staff and assets	
Check the legal position	
Decide what additional information is required and how it can be obtained	

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Step two: Get SRI on the agenda

Once information has been gathered it is important to bring the issue onto the agenda with important stakeholders within the organisation in order to build agreement. Using this guide can help to address some of the most important concerns.

It may be helpful to

- Discuss SRI at a trustee meeting
- Discuss SRI at a senior management meeting
- Make the case for why SRI would be a sensible choice for the charity
- Consider inviting 'an expert' such as a finance director from within the sector to talk about their experiences, the benefits that it has brought to their organisation or to answer questions on what the process entails
- Clarify who within the charity is best placed to take this work forward. This could be a trustee, the finance director, or a working group of interested staff and/or trustees. Ensure they have been brought in on discussions

Get SRI on the agenda checklist

Ensure that SRI has been raised with key decision makers and that a commitment has been made as to how to proceed	
Clarify who is best placed to take this work forward and communicate with them	

Step three: 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. You should consider the charity's motivations for adopting Responsible Investment and how it links to the charity's objects, strategy, investment approach and risk assessment. This is a crucial stage that is important to carry out fully in order to progress initial ideas into an investment policy at a later stage easily.

What factors should I be thinking about?

- Consider how investment links to your charity's mission, strategy, and risk assessment, particularly around reputational risk.
- Consider the charity's motivations for adopting SRI, for example, is it to avoid alienating stakeholders, avoid conflict with aims and activities or to address financially relevant social, environmental and ethical risks?
- The nature of a charity and its activities should also be factored in, especially with regards to key stakeholders who should be involved in setting aims. For membership charities, trustees may wish to consider members' attitudes on whether investment decisions should reflect the charity's values.

Others may wish to consult with staff from across the organisation or the charity's beneficiaries.

Action Aid

ActionAid feel that having sight of where their funds are invested is vital to ensure that they are not investing in companies that conflict with their mission and wider campaigns work. Being aware of the potential far-reaching impact of their investment strategy the charity brought together representatives from across the organisation including finance, fundraising, public affairs and policy and campaigns when reviewing their investment policy.

The principles adopted by the charity to lead their investment strategy include ensuring ActionAid's values are upheld, that the charity maintains good standing with its supporters and that investments are not held in companies targeted by the charity's campaigns.

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 four: Develop or update your SRI policy

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

Consider

Content: Which ESG issues to address?

Which environmental, social, ethical and governance issues do you wish to incorporate into your investment decisions? Considering aims, the issues that are at the heart of your charities mission and the views of key stakeholders is key at this stage. Suggestions of the types of issues that can be factored into investments are listed at www.charitysri.org

Doing initial research on the content of the policy can be helpful to clarify the implications of different issues. For example, a cancer charity may wish to screen tobacco out of their investments. Research may demonstrate that excluding all companies involved with tobacco would exclude all supermarkets as well as tobacco producers and that it would better fit your aims to set a materiality threshold so that only companies with over 10% of their turnover from tobacco were excluded. If the charity is considering a support approach, researching appropriate investment opportunities can help to clarify thoughts here.

Which approach to take? Screening, engagement?

This will be influenced both by the aims set for SRI and practical considerations. For example a fundraising charity with a narrow scope of work, for example animal welfare, and limited resources may find a negative screening approach is appropriate because it fits with its mission, and is cost-effective. A charity with a large endowment may prioritise engagement in order to mitigate financial risks to its investments as well as a positive screening approach where the portfolio is biased towards companies in sectors the charity believes to be beneficial. A smaller charity may decide to review options available in pooled funds and current accounts.

The What's Right for Your Charity? tool at http://www.charitysri.org/tailored.html can help to explore the best SRI fit with your charity and your aims.

The end result of this stage should be a written policy that lays out aims, content and focus.

Addressing these questions will help to check that the written policy is comprehensive

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

Develop an SRI policy checklist

Identify any areas of investment which would directly contradict the charity's work	
Decide if there are other investments you would be keen to avoid	
Identify any investments you would like to promote as positively furthering the work of the charity	
Become aware of the possibilities of and resources required for engagement	
Become aware of how the policy will affect the balance of investments through initial research	
Consider how the SRI policy can fit within the organisation's overall investment policy	
Produce a written policy document which lays out aims, content and focus	
Ensure compliance between the policy and the charity's governing documents and legal requirements	
Sign-off the Responsible Investment policy	

Step five: Implement policy

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

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'[6]

[6] 'Charities and Investment Matters: a guide for trustees (CC14)', www.charitycommission.gov.uk

As implementation is often delegated to staff and fund managers it is crucial that trustees take time to explain the policy.

Implementation options

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. Charities, especially smaller charities, may wish to pool all or some of their funds in an ethical pooled fund with a low minimum required investment level.

Other financial products

Current accounts, credit cards and insurance policies can also be switched to ethical alternatives. www.yourethicalmoney.org is an independent comparison website which can be used to search for a range of ethical financial products that meet the charity's specifications.

New or existing fund managers?

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, current and potential.

Questions to ask fund managers

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

Integrating the SRI policy within the charity's overall investment framework, may minimise costs and make implementation more effective. The fund manager may have implemented SRI for other clients whilst maintaining the same level of investment return and fee structure.

Implement policy checklist

Identify to whom the policy should be communicated	
Clarify the role of the trustee body, staff and advisers	
Determine the best implementation strategy and appoint managers and advisers	
Ensure that clear instructions have been delegated to the fund manager	
Monitor the implementation and impact of the policy	

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Step six: 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. To ensure that this is the case an effective and on-going monitoring process should be established. It should include an assessment of the impact of SRI 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, 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 improve a charity's 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 SRI 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 to relevant stakeholders	
Ensure that the SORP reporting requirements are met	

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

Conclusion

Socially Responsible Investment offers a wide range of benefits for charities. At a time of increasing demand for charity transparency, SRI is essential for enhancing reputation. For long term investors, SRI can also help to mitigate financially material environmental, social and governance related risks.

Crucially, SRI offers charities an opportunity to ensure that across all areas of their operations, positive impact is extended and not undermined. The recent financial crisis has demonstrated the significant impact that the financial system can have on some of the world's most vulnerable communities. For charities working to alleviate some of the problems caused or aggravated by the crisis, the importance of being a responsible investor and of using their influence to harness financial systems so as to build a more sustainable future has perhaps never been clearer.

SRI is straightforward, legal for charities and supported by an ever increasing body of evidence that overwhelmingly demonstrates that it is possible to choose investments which make a positive difference without sacrificing financial performance. It can easily be incorporated into current investment practices and implemented incrementally with limited resources. Help is available through those who have already gone through the process, through advisors and fund managers with expertise in this area as well as through a wealth of guides and resources written for charity investors including **www.charitysri.org**

We hope that through this toolkit trustees are better able to ensure that their investments work as hard as possible; both to provide both the best returns for the finances of the charity, and to further their wider societal goals.

SRI Checklist

1. **Gather all necessary information on the charity's current investments, resources available and legal position**
2. **Ensure that SRI has been raised with key decision makers and that a commitment has been made as to how to proceed**
3. **Consult with key stakeholders: members, beneficiaries, staff**
4. **Establish clear aims**
5. **Identify important issues: areas to avoid, areas for positive investment and a policy on engagement**
6. **Consider whether these actions meet your aims**
7. **Produce a written policy that complies with the charity's governing documents and legal and reporting requirements**
8. **Determine the best implementation strategy - clarify staff and trustee roles**
9. **Appoint managers and advisers and ensure that clear instructions have been delegated**
10. **Monitor the impact of the policy and determine whether SRI has achieved its aims. If not, identify the reasons and where improvements can be made. If so, report your success with pride!**

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About EIRIS Foundation

The EIRIS foundation is a charity that supports and encourages responsible investment. It promotes research into the social and ethical aspects of companies and provides other charities with information and advice to enable them choose investments which do not conflict with their objectives. Its wholly-owned subsidiary, EIRIS, is a leading global provider of independent research into the environmental, social and governance, and ethical performance of companies.

About CFDG

The Charity Finance Directors' Group (CFDG) is the charity that supports charities in their finance-related functions, promoting best practice in charity finance, driving efficiency and helping organisations to make the most out of their money. CFDG's circa 1,700 members – all senior financial professionals in the voluntary sector – are responsible for managing around £21.75 billion in charity funding. Our members work at the heart of the strategic development of their organisations, and are at the forefront of delivering a sustainable and efficient charity sector.

For further information, resources, databases of fund managers and independent financial advisors that specialise in SRI visit www.charitysri.org or contact 020 7840 5700 or charitysri@eiris.org

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