CHARITY SRI

Helping charities invest responsibly

Are Charity Consultants Helping or Hindering the Development of SRI?

Discussion Paper

EIRIS Foundation Charity Project

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EIRIS

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Key Findings

Some advisers do not see it as their role to ask charity investors about socially responsible investment (SRI)[1], particularly if it is a charity with general charitable purposes.

Survey findings suggest that advisers may be less likely to ask charities that don't invest ethically about SRI and may be more likely to be discouraging

Most advisers agree that the consideration of social and environmental risks should not harm returns in the long-term, and could improve them. But some advisers always counsel clients of the short-term risks of under-performance and volatility.

Advisers highlight a lack of appropriate products as one of the limiting factors to the promotion and take-up of SRI.

Advisers feel that demand for SRI is limited by the views of trustees – particularly in relation to financial performance and legal duties.

[1] SRI can also be known as responsible or ethical investment. It involves the consideration of social, environmental, ethical or governance issues in investment decisions.

Trustees, charities, advisers and investment managers could all take steps to address these challenges and enable more investments to be made in line with mission. In particular advisers could do more to

- **Raise SRI issues with all charities**
- **Provide information and training to trustees**
- **Include environmental, social and governance (ESG) issues in standard reviews of investment managers**
- **Keep informed of the latest developments**
- **Communicate market gaps to fund managers**

1. Introduction

Socially responsible investment (SRI) enables charities to invest in line with their mission, avoiding conflicts with their work and risks to their reputation.

91% of the general public believe that charities should invest ethically[2], but practice falls a long way short of this. A 2009 survey by the Charity Finance Directors' Group (CFDG) and EIRIS Foundation of 164 charities revealed that 46% had an ethical investment policy – though this increased to 60% for charities with investments over £1million.

Investment advisers and consultants can play a crucial role in the decisions that charities make about their investments and whether to consider social, environmental, ethical or

[2] According to a GFK NOP survey of 2,000 adults commissioned by the EIRIS Foundation Charity Project

governance factors. Some advisers have been criticised for discouraging charities to consider ethical or socially responsible investment (SRI) and linking their investments with mission. But as the SRI market evolves and interest in environmental, social and governance (ESG) issues increases, what do the advisers think now? Are they helping or hindering the development of SRI in the charity sector?

This paper considers what charity advisers think about SRI, how they see their role in the evolving SRI market and what would increase the take up of SRI by charity investors. Quotes from Charity Advisers are included throughout the report. We compare these to the views of charities and evidence from the wider SRI sector to examine the real and perceived barriers to change.

It is based upon conversations with a small sample of the leading charity advisers and consultants in 2008 and the findings of a survey conducted by the CFDG and EIRIS Foundation of 164 CFDG members in early 2009. The paper is put together by the EIRIS Foundation Charity Project, an initiative which increases awareness and understanding of SRI amongst charities through the provision of education, research and resources – including the website www.charitysri.org

2. Asking the ethical question

In general, advisers report that less than half of their charity clients ask about ethical issues.

Some consultants are happy to raise the issue of SRI and discuss the options with all clients. For others SRI may emerge from more general discussions about the needs of the charity. Others do not see it as their job to raise the issue – and are concerned that they may be seen as pushing an idea onto clients which could "come back to haunt them later".

From the charity perspective, the CFDG/EIRIS Foundation survey found that two thirds of advisers had asked about ethical considerations, but there is a distinction between charities that have an ethical investment policy and those that do not. For those charities with an ethical investment policy, 87% said that their adviser had raised the ethical issue, but for those without this fell to 43%.

When ethical investment was raised, 15% of charities without an ethical policy said that advisers were discouraging or very discouraging. This compares to 4% of charities with an ethical policy. This is based on a small number of charities, and whilst it cannot be concluded that these charities have not adopted SRI because it was not raised, or because advisers were discouraging, this situation will not help to change the status quo. There may be many charities, therefore, that are not encouraged to place their investments in line with their mission, and could be at risk of reputation damage.

Advisers tend to assume that certain kinds of charities will naturally want to consider certain ethical issues (such as medical charities screening out tobacco) but that others will not be interested. This may perpetuate the trend amongst charities for negative screening.

However, a 2009 report from the Asset Management Working Group of the United Nations Environment Programme Finance Initiative (UNEP FI) calls on investment consultants to be much more proactive in raising and addressing ESG issues. The report focuses on large asset owners, but its conclusions could be applicable to all investors given the growing recognition of the financial impact of ESG factors. The report states that consultants face a very real risk of being sued for negligence if they are not proactive in incorporating ESG factors into legal contracts with institutional investors.[3]

3. Views of SRI

The language of SRI varies across the advisers we spoke to and the terms they use can carry positive or negative connotations. For example, a different message can be conveyed by discussions of ‘responsible investment issues’ rather than ‘ethical constraints’. Ethical constraints can signify negative screening and a reduced investable universe. Negative screening may be entirely suitable for some charity investors, but in practice SRI can go far beyond traditional negative screening approaches. The language of responsible or sustainable investment meanwhile, conveys long-term astute investment decisions.

Concerns over financial performance tend to act as a barrier for the adoption of SRI. 40% of charities that responded to the CFDG/EIRIS Foundation survey identified concerns over lower financial returns as a barrier to SRI

Do advisers share these concerns and pass them on to charities?

There was general agreement amongst the advisers we spoke to that the consideration of social and environmental risks should not harm returns in the long-term, and could improve them.

[3] UNEP FI (2009) “Fiduciary II” report—Fiduciary Responsibility – Legal and Practical Aspects of Integrating Environmental, Social and Governance Issues into Institutional Investment

“I believe that to make better investment decisions you need to consider information on ESG factors, and the broad risks and opportunities that will affect performance. This could include climate change, human rights, supply chains, nuclear etc. These considerations relate to long term performance – for example, for the nuclear industry consideration of the disposal of nuclear waste and potential for costs and regulation in future, rather than the ethical nature of nuclear power.”

But one adviser we spoke to always counsels clients that SRI carries the risk of financial underperformance and greater volatility and another commented “in the short-term ethical investment can have a marked effect on performance.”

However, there are now many years of practical experience demonstrating that ethical funds need not underperform. In fact a well-managed, balanced ethical portfolio can outperform its non-ethical peers.[4] For example, Bauer et al examined 103 international ethical mutual funds from 1990-2001. They found: “Little evidence of significant differences in risk-adjusted returns between ethical and conventional funds.”[5] The degree to which a particular SRI approach has a beneficial or a detrimental impact on performance will primarily rest with the skill of the fund manager and their team – and in particular their stock selection abilities.

[4] See the research evidence listed at www.charitysri.org/for_charities/financial_returns.html
[5] Bauer, R, Koedijk, K. and Otten, R (2002) International Evidence on Ethical Mutual Fund Performance and Investment Style. ABP Investments/Maastricht and Erasmus University

A focus on short-term performance has been blamed in recent times for contributing to the economic downturn and acting against the long-term interests of investors. But many advisers emphasise short-term issues in discussions of SRI. Perhaps the requirements of some investors for short-term performance reporting are also a factor in the focus on short-term issues.

According to the advisers, charity practice tends to fall behind that of pension funds. Whilst interest in SRI from charities is growing, many advisers feel this is not happening across the board, and interest isn't necessarily leading to increased demand.

"Charities tend to be behind the curve – they are slower to adapt to new trends."

It is true that negative screening remains by far the most popular SRI strategy amongst charities, and this tends to be used to avoid conflicts with aims and activities and to avoid reputational damage. The CFDG/EIRIS Foundation survey highlighted that one in four charities with an ethical investment policy use positive screening, and 60% of charities with investments over £1million invest ethically. So perhaps charities are not as behind the curve as some advisers contend.

4. Challenges

The advisers raised a number of issues that limit the adoption of SRI. We have set these out below in terms of supply of and demand for SRI.

4.1 Supply

There are a number of factors that advisers say restrict them from finding or recommending SRI options for charity investors. In the view of advisers:

- Funds with general ethical screens often don't fit with the specific issues of most relevance to charities.
- There are limited options for investing outside the UK.
- There are limits to the availability of products other than equities – such as private equity or hedge funds, restricting the opportunities for diversification.
- Ethical options can be seen as too volatile to fit with the risk profile of charity investors
- Advisers feel some of the investment managers providing SRI services are of insufficient quality, limiting the range of services they are willing to recommend

It does not follow, however, that these factors are all real barriers. The range of available SRI products and services continues to expand to meet increased demand. There are now almost 100 retail green and ethical funds domiciled in the UK. At the end of 2007 the European SRI market was estimated to be €2.665 trillion, representing a growth of 102% in two years.[6]

Several fund managers of Responsible Investment funds are rated as AAA or AA by Citywire, and a 2005 Lipper Citywire All Stars Award was won by an ethical investment fund manager. According to Citywire, "fewer than 5% of all UK fund managers achieve an AAA rating... If they do, it means that they have performed very well and are among an elite."

There is also a number of fund managers that successfully manage segregated charity portfolios. The Joseph Rowntree Charitable Trust

[6] Eurosif (2008) European SRI Study 2008

employs negative and positive screens and its portfolio, which is managed on a segregated basis, outperformed its benchmark in seven of the last nine years.

4.2 Demand

Why does demand for SRI services remain limited? Most of the advisers put this down to the role and attitude of trustees:

- Trustees are busy people with full-time jobs and the voluntary nature of trusteeship means that insufficient time is devoted to investment decisions.
- Trustees see their role as short-term, expecting to be involved with a charity for a limited time period of three to five years. Their thinking in relation to investments therefore tends to fit with these time horizons.
- The assumption that SRI will be more volatile means that trustees would not want to be seen to oversee investments that are underperforming at any specific time – especially by their peers.
- Trustees can have entrenched views on investments and do not want to impose any constraints on investment managers that they believe could harm returns.
- Trustees do not want to impose their own moral views on investments and feel that imposing ethical considerations is going beyond their remit.

Whilst it is true that trustees should put the interests of the charity at the forefront of investment decisions, rather than their personal interests, this does not mean that 'moral issues' cannot be considered. The Charity Commission recognises that provided there is no risk of significant financial detriment trustees can 'accommodate the views of those who consider certain investments to be inappropriate on moral grounds,'[7]

It is argued that issues such as climate change will be increasingly relevant to the performance of companies, and so are relevant for all investors, whatever their moral standpoint or the mission of their organisation. Factors such as regulation, licence to operate, the price of energy and waste disposal, changing weather patterns and the impact on resources, reputational issues and the potential for future lawsuits indicate the financial relevance of climate change for all investors.

As mentioned above, there is ample evidence that SRI does not have to mean under-performance. The pursuit of 'maximum' returns is always subject to constraints, such as fund manager skill, asset allocation, risk profile and time horizons, which may have a more significant impact on performance than SRI considerations.

A focus purely on the financial performance of investments neglects the potential costs of damage to reputation and donor relationships if a charity is exposed as having investments that counter its mission.

"Trustees need to change their view of their obligations – they are not in a moral vacuum and they can go beyond their governing documents."

Trustees are not as restricted as some may believe in terms of their legal duties. An increasing number of pension funds recognise that investors have a duty to act as responsible owners, to consider the sustainability of their investments and to protect the

[7] Charity Commission (2004) CC14: Investment of Charitable Funds

interests and the environment of future beneficiaries. Charity trustees should be doing the same.

"Trustees need to raise their game, particularly in relation to corporate governance issues. And there is much more scope for engagement – including engagement with fund managers."

Some trustees may take issue with the views expressed by advisers about their role and appetite for SRI. According to the CFDG/EIRIS Foundation survey, 75% of charities that invest ethically said that the drive for this came from trustees.

Whilst there may be limits to the supply and demand for SRI for charities, the intermediary role of advisers means that they could be doing more to breakdown the perceived barriers, provide clear and up to date information to trustees and communicate gaps in unmet demand to service providers.

5. The future of SRI

The advisers agree that demand and supply will increase in future, whether it be greater integration of ESG issues by mainstream fund managers or the establishment of new SRI funds.

The CFDG/EIRIS Foundation survey found encouraging signs that more charities plan to adopt ethical investment, 32% of charities that do not currently invest ethically are planning to discuss the issue in the coming year.

"The environment is no longer seen as a minority protest issue but a legitimate societal concern. The issues are now more mainstream and part of general risk management. Charities don't want to be caught out for inconsistency. And the growth of internet and press interest means this information can spread widely and rapidly. SRI is moving from a niche to wider integration..."

6. Recommendations from advisers

From the adviser perspective there are a range of measures that could help to address the challenges to the greater take up of SRI, on both the demand and supply side. The suggestions from advisers included:

For those working with and for charities

- The perception of performance needs to change – it should not be seen as something which has to be sacrificed to invest ethically.
- More education of trustees is needed, for example through the provision of better information and training.
- Investment policies should include a recognition of volatility
- More clarity is needed over how far charities should go when setting their investment policy e.g. the level and extent of negative screens
- More work is needed to help understand the social impact of screening. Without this some charities will not be convinced of its value.

For investment managers:

- More products are needed that fit with the mission, portfolio and risk profile of a variety of charities.
- More high profile well-performing ethical funds will help to increase demand.

- More clarity is needed from fund managers about their responsible investment approach

For charities:
- Trustees need to be pragmatic in their approach and accept that nothing is perfect.
- Trustees should be encouraged to become more informed of SRI developments, for example through training.
- Trustees need to look at the long-term

7. Recommendations for advisers

On the whole, advisers do not see it as their role to respond to any of the challenges identified above. But there is a range of ways in which the adviser community could support the development of SRI, or at least not act as a barrier to its development.

Addressing some of these challenges could be in the best interests of advisers as well as their clients. The 2009 UNEP FI report mentioned above argues that investment consultants working with large institutional investors have a legal responsibility to incorporate ESG issues into investment services.

Issues such as corporate governance and climate change are more high profile than ever in the investment community. As the significance of ESG issues is increasingly recognised by mainstream investors the market for advice on responsible investment is also set to grow. Being at the forefront of new developments could help advisers take advantage of this growth.

Advisers could do more to:

Raise SRI issues with all charities
Advisers play a pivotal role between investors and investment managers and should be much more proactive in raising responsible investment issues with charities and explaining the spectrum of approaches that can be used to align investments with mission and mitigate ESG and reputational risks.

Provide information and training to trustees
A small number of consultants are already working proactively to provide information and education for trustees.

Include ESG issues in standard reviews of investment managers
One leading consultant already includes ESG research and investment processes into its overall assessment of fund managers. This information can be used by clients to understand the quality of responsible investment processes alongside other factors.

Keep informed of the latest developments
Many advisers need to better understand the latest developments in responsible investment, in terms of new strategies and approaches, new products and latest research on issues such as financial performance and fiduciary duty. New resources, research and events may help with this, particularly from a ‘trusted’ mainstream body.

Much of this information is available on www.charitysri.org and a regular newsletter is available free to subscribers.

Communicate market gaps to investment managers
Advisers can also represent the views of charities to investment managers and explain any potential unmet demand for a broader range of SRI products.

Changing the views and practices of trustees is likely to be a very slow process. The EIRIS Foundation Charity

Project will be working to increase awareness, understanding and adoption of SRI among charities. Through our publications, website, events and promotion activities we will aim to provide trustees with the information and tools to decide on an SRI approach, assist in the development of a policy and provide the questions to ask of advisers and investment managers.

Further information

For more information about the EIRIS Foundation Charity Project visit www.charitysri.org email charitysri@eiris.org or call +44 (0)20 7840 5738.

About the EIRIS Foundation

The EIRIS Foundation (www.eirisfoundation.org) is a charity, established in 1983, that supports ethical investment. It researches the social and ethical aspects of companies and provides other charities with information and advice to enable them to choose investments which do not conflict with their work. Ethical Investment Research Services (EIRIS) Ltd, a subsidiary company of the Foundation, provides the independent research into corporate social, environmental and ethical performance that is needed by investors to make informed and responsible investment decisions as well as by charities wishing to screen their donors or suppliers.