

**Response to Charity Commission Consultation:
'Charities and Investment Matters'**

The submission of the EIRIS Foundation and EIRIS Ltd

1. Details on the Respondent

The EIRIS Foundation (www.EIRISFoundation.org) is a leading UK charity working in the area of responsible investment.

The Foundation has over 25 years experience of providing free, objective and trusted information on ethical finance to charities and members of the public. Online resources include www.CharitySRI.org and www.YourEthicalMoney.org. The Foundation has worked for many years assisting charities in the implementation of responsible investment policies.

The Foundation's subsidiary, EIRIS Ltd, researches the environmental, social, governance and ethical aspects of over 3,000 companies globally. EIRIS is a not-for-profit organisation; its mission is to empower investors with independent assessments of companies and advice on integrating them with investment decisions. EIRIS provides services to fund managers, banks, pension funds, charities and NGOs worldwide.

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2. Our Response

EIRIS welcomes the guidance from the Charity Commission. Overall the guidance is clearer in explaining the requirements and opportunities for charities to explore responsible investment compared to previous guidance. We also welcome the fact that guidance on responsible investment is now fully integrated into the main Charities and Investment Matters' guidance document.

Undoubtedly it will be a useful resource for charity trustees and their advisors going forward. We acknowledge the importance of the document and the necessity for this to be as accurate and forward-thinking as possible, as trustees will be giving this document great weight when considering investment decisions for many years to come and may not look beyond it, but regard it as a 'legal instruction'. Statements expressed in the guidance may have unintended consequences, unless each statement and thinking behind it is clarified and consequences considered in full. With this in mind, we set out below a few key points that we believe it is essential to address.

2.1 Overall Approach

2.1.1 Terminology

For ease of understanding, EIRIS is using the term 'responsible investment' as an umbrella term in this response. To a large extent various terms can be used interchangeably and the term 'responsible investment' can encompass them all. Charities and trustees often still feel comfortable with the term 'ethical

investment', which can also refer to other terms, such as 'socially responsible investment' and 'responsible investment'. We would encourage the Charity Commission to go further to note and clarify the meaning of alternative terms relating to responsible investment in the introduction and glossary in the guidance. Reference to other terms used in the investment industry should be explained in order to avoid confusion.

2.1.2 Charity World View and Reputation Risk

Charities aim to make a difference to the world in some way on a particular issue, often by seeking funds and donations from the public. Some charities are now thinking of their finances within this world view and realising the impact that their financial investments can have towards implementing their 'mission'. We would encourage the Charity Commission guidance to state that charities should consider how their financial investments can also reflect their 'mission', rather than entirely separating investment-decision-making from other aspects of a charity's activities. This is fundamentally lacking in the guidance.

Segregating investment decisions from a charity's wider work crucially risks a charity's reputation if stakeholders (for example, employees, supporters, trustees, donors, spokespersons and partner organisations) were to become aware that a charity's finances were incongruent with all their work, directly acting against their 'mission' or aims. This is an enormous potential risk and public awareness of this issue is increasing. Research by the EIRIS Foundation and Holly Hill Charitable Trust finds that the public think worse of charities that do not invest ethically; a recent survey 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.¹ Negative screening remains a viable option for charities who may wish to avoid investing in activities which contradict their 'mission', though this can be augmented by positive screening and engagement, as appropriate. The Charity Commission guidance is an opportunity to inform charities of the potential conflict between certain types of investments and a charity's aims, recognising the impact their investments can have towards implementing their 'mission'.

Charities inevitably cannot, and perhaps need not, address all potential environmental, social, governance and ethical issues when making investment decisions, but they can explain which issues are material to them and how they are addressing these. For example, if a charity works to prevent human rights abuses, a charity risks alienating its supporters if it is revealed that the charity invested in companies manufacturing controversial weapons or sovereign bonds from a country that had breached UN conventions on human rights.

We would therefore support a best practice statement in *Section A: Introduction* to the effect that charities should consider the potential reputation risk of financial investments conflicting with their 'mission'. The Charity Commission may also choose to recommend that charity trustees would be wise to devise a public position statement or policy which outlines their overall approach to their financial investments, particularly with regards to any investments that conflict with their 'mission', that they can explain to the public, in order to manage this potential reputation risk. For example, a charity may have invested in companies with behaviour that conflicts with their aims, but the charity has done so in order to engage with the companies to make them change for the better. Transparency and accountability is to be encouraged.

2.1.3 Fiduciary and Stewardship Duty

The guidance as a whole (particularly sections A, B, C and Part 1) lacks reference to, and explanation of, what is increasingly seen as the need for trustees to consider environmental, social and governance ('**ESG**') risks when making investment decisions. Frequent reference is made to ensuring what might be called 'pure' financial return, without referring to an extended and more inclusive notion of a trustee's fiduciary duty as stewards of a charity's assets.

A report by the law firm Freshfields Bruckhaus Deringer states that ESG issues should be taken into account in every investment decision, even if in the end they are given little weight:²

"Conforming with the correct process requires decision-makers to have regard to all considerations relevant to the decision, including those that impact upon value. In our view, decision-makers are required to have regard (at some level) to ESG considerations in every decision they make. This is because there is a body of credible evidence demonstrating that such considerations often have a role to play in the proper analysis of investment *value*."³

"A majority of the jurisdictions have legislated (or are expected to do so shortly) to require investment decision-makers, particularly in the pensions context, to disclose the extent to which they take ESG considerations into account... Such legislative endorsement of the relevance of ESG considerations to investment decision-making constitutes an important additional factor in favour of the view that decision-makers must have regard to ESG considerations at some level, even if they are ultimately given little or no weight."⁴

Whilst the above guidance is primarily directed towards asset owners such as pension funds, endowed charities in particular have the same need to safeguard their assets and financial returns over the longterm. Indeed, arguably all investments should be subject to such a fiduciary oversight, as ESG risks can affect financial return. Mainstream investment thinking increasingly supports the view that consideration of ESG factors in investment decisions is part of fully considering investment risks; for example, considering how to prepare for certain eventualities (such as climate change, or political sensitivities) through particular investments and considering the long-term sustainability of investments. Indeed, it may well be that investing in particular activities such as tobacco, alcohol and gambling, are not necessarily financially sustainable over the longterm, due to the external social costs that derive from such activities.

Preserving the long-term sustainability of assets is often deemed to be appropriate by other asset owners, such as pension funds and wider institutional investment owners. This has been reflected in the drive towards active ownership and stewardship of assets, seen in the UN Principles for Responsible Investment initiative⁵, a voluntary set of principles which aims to encourage institutional investors to integrate ESG issues into their investment decision-making, and the UK Financial Reporting Council Stewardship Code, a code that aims to enhance engagement between institutional investors and companies to improve the long-term returns for shareholders and better exercise of governance responsibilities.⁶

The Charity Commission could include guidance on what constitutes good governance within a charity. We would support a statement that encourages co-ordinated thinking within a charity between those persons working in the operations and financial sides. It might be helpful to suggest that committees

making investment decisions should include persons who not only understand financial investment decision-making, but also understand a charity's 'mission'.

The above-mentioned initiatives indicate the investment industry's wider movement towards active shareholder-ownership, greater transparency and greater accountability at all levels of the investment chain. The Charity Commission's guidance is an opportunity to similarly encourage charities to keep in line with these developments. We would encourage charity trustees to be similarly transparent and accountable to their beneficiaries. The Commission could include guidance urging charities, including endowed ones, to have a clear statement of investment principles.⁷ The guidance could state that it is good practice for charities to include in their annual reports whether they have considered ESG issues in their investment-decision-making, to disclose whether they have a responsible investment policy, and to state how this policy relates to its 'mission' and investment strategy. The guidance could also encourage charities to state their responsible investment policy on their websites.

2.1.4 Guidance Structural Issues

The guidance would be further enhanced if it was structurally amended to set out at the beginning overall high-level policies and principles on charities and investment, backed by case law, followed by detailed guidance. Reference to the Bishop of Oxford case⁸ could be made in this context at both the introductory section and subsequent sections.

The categorisation of types of investment into 'financial investment', 'ethical investment', 'mission connected investment' and 'programme related investment' is a helpful way to try to clarify a complex area for trustees. However, it needs to be clarified further. Although responsible investment is mainstream but still evolving, it needs to be stated that there can be instances when types of investment may fall between these categories and that they are not definitive. At present, the categories may be confusing for trustees and may unnecessarily discourage them from exploring responsible investment. We would therefore endorse some introductory wording that sets out what a trustee committee considering investments should do and provides an overview of the types of opportunities that are available, through different types of investments. This would clarify that these 'approaches' and their corresponding sections in the guidance, are options; charities can pick and choose any, all or a combination of these options, they do not need to have investments reflecting some of each of these approaches in their investment portfolio.

2.1.5 Financial Return

The term 'best financial return' is likely to be open to misinterpretation. The use of 'best' is too close to 'maximum'. A term is needed that reflects how good financial return should be commensurate with risk and a term that takes into consideration the lifetime of the intended investment. We would suggest that words such as 'proper' or 'appropriate' may be alternatives here.

We have read the draft submission to this consultation by the Joseph Rowntree Charitable Trust and would endorse their point that:

"[t]he draft appears in places rather simplistic about making the "best" financial return, because there is no guaranteed way of doing this and high returns tend to go with high risk. Return on investment is never guaranteed in advance. Dependent on the economic situation different investments do better at different times. During the credit crunch the

Ethical Property Company, a social enterprise, survived in a much healthier financial condition than many highly leveraged property companies and even increased its dividend.”⁹

2.2 Part 1 Financial Investment (Sections D to H)

2.2.1 Overview of Financial Investment Section

As mentioned above, reference needs to be made to consideration of ESG risk in investment decisions. Reference could also be made to reports that have indicated the importance of taking these issues into consideration. In particular, section D6 *What risks do trustees need to be aware of when investing* is entirely lacking in this regard and should include reference to consideration of ESG risk.

The merits for each particular charity of an investment regarded as a ‘financial investment’ may thus be affected by ethical considerations and by reputational considerations related to ethics. It should therefore be made clear that advice should be taken not only on the financial characteristics and prospects of any investment, but also on its ethical merits for the charity. This point should also be made in other sections, e.g. in section E *Making decisions about financial investments*.

In section E and specifically sub-section E1, there needs to be an explanation of what charities should include in their investment policy with regards to responsible investment. We would suggest that it should at the very least include a description of what the charity considers to be the material ethical issues that may be of concern to the charity and how the charity intends to address these (for example, through positive screening, negative screening and / or engagement approaches). Charities are to be encouraged to be transparent about their policies and ideally make these available for the public to view on their websites. In sub-section F3 the investment-policy statement is described as ‘written’ when the trustees are delegating decisions to an investment manager. We would encourage a best practice statement here, stating that the policy statement should also be publicly available, to encourage transparency and confidence in charities.

In sub-section E2 governance risks are described. These need to be explored in broader terms, not just with regards to non-mainstream funds. Best practice governance includes broader consideration of ESG factors as well as a charity’s reputation risk, as referred to above.

In section F *Using an Investment Manager*, we would request that greater emphasis is given to the fact that if ESG issues are relevant to a charity, then its advisers and consultants, as well as investment managers, need to demonstrate capacity and experience in ESG matters. Charity trustees cannot assume that every investment manager is an expert in this area. Charities should be encouraged to assure themselves that any investment manager they choose has the skills to be able to address the issues of concern to them. FairPensions’ survey of fund managers has found that expertise on all ESG components and transparency can vary within the fund management industry.¹⁰ Similarly, the EIRIS Foundation’s survey of advisers finds that some advisers do not see it as their role to ask charity investors about responsible investment, particularly if it is a charity with general charitable purposes; advisers may be less likely to ask charities that don’t invest ethically about responsible investment and may be more likely to be discouraging.¹¹ The EIRIS Foundation’s and Charity Finance Directors’ Group’s toolkit for trustees on responsible investment suggests questions trustees can ask fund managers, as part of the process of determining

if they have adequate expertise in responsible investment. Questions may include:

- “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?”¹²

In addition, the Charity Commission guidance could also urge charities to include consideration of ESG issues in their investment management agreements with asset managers and with a requirement for the asset manager to report progress.

We endorse the inclusion of a section dedicated to ‘ethical investment’ in section G *Ethical investment and mission connected investment*, primarily because we recognise that the term ‘ethical’ is the term that probably resonates most with charities, when considering how their financial investments fit with their ‘mission’.

However, in section G reference could be made again to the Bishop of Oxford case at the beginning of the section. In sub-section G2, explanation and guidance is also needed as to the meaning of the term ‘evidence’. Arguably there is overwhelming evidence that the public expect to see charities adopt ‘ethical investment’, as seen by the results of the EIRIS Foundation’s recent survey of the public’s attitudes to charities and their investment policies.¹³

In the guidance, with regards to the requirements trustees must meet when taking an ethical approach to investment, the requirement for the investment not to result in significant financial detriment is too strongly worded; it is not possible to be absolutely certain that a financial investment ‘will not’ result in financial detriment. We would therefore suggest that this wording be amended to be less absolute.

Charities may not be aware that opportunities and solutions to the challenges charities face can be found in types of investments already in existence in the mainstream. We would therefore encourage this to be addressed in the guidance.

3. Further Suggestions and Action Points

The inclusion of examples throughout the guidance is helpful. However, we would like to see a wider range of more compelling examples. It also might be useful to attach some case studies as an annex to the guidance (without names necessarily) of types of investments made by charities. For example, the Charitysri project website www.charitysri.org includes case studies from various well-known charities that have a responsible investment policy.¹⁴ Charitysri, a project by the EIRIS Foundation, is aimed at charities, their supporters and service providers, providing information and resources on responsible investment (what it is, reasons for doing it and how to go about it).

The Charity Commission might also want to consider commissioning some supplementary guidance materials for charities on responsible investment, which could take the form of informal guidance or toolkits produced subsequently. As mentioned earlier in this response, the EIRIS Foundation and Charity Finance

Directors' Group have produced a toolkit for trustees interested in practically exploring socially responsible investment.¹⁵

EIRIS and the EIRIS Foundation would be delighted to assist the Charity Commission by further consultation or the production of related guidance for charities on the subject of responsible investment. The EIRIS Foundation has worked to promote responsible investment for many years, and in fact was the first charity in the field working with charities and other investors to promote responsible investment. If requested, we are happy to be consulted and / or to produce complementary resources, including toolkits and case studies for the Charity Commission.

28 February 2011

References

¹ The survey, 'What is the UK public's opinion of charitable investments?', was conducted to gauge the public's opinion of charitable investments. <http://www.eiris.org/media.html#CharitySurv2011>

² Freshfields Bruckhaus Deringer, (2005). 'A legal framework for the integration of environmental, social and governance issues into institutional investment'. Produced for the Asset Management Working Group of the UNEP Finance Initiative

³ Freshfields Bruckhaus Deringer, (2005). 'A legal framework for the integration of environmental, social and governance issues into institutional investment'. Produced for the Asset Management Working Group of the UNEP Finance Initiative, p. 10 -11.

At Appendix H, United Kingdom, p.145 it also states that, "[t]he overriding duty that affects trustees' ability to take account of ESG considerations in administering financial trusts is their fiduciary duty to act prudently and for a proper purpose. Even where they delegate day-to-day decision making to a fund manager, trustees bear an overriding duty to ensure their investments are managed appropriately in the interests of beneficiaries.

Foreseeably, trustees might also be liable in negligence if they fail to apply a sufficient standard of care to their decision-making, but we think it is highly unlikely that a trustee who can show that it meets its fiduciary duties would be found to have breached its duty in negligence, the content of the duty in negligence being informed by the fiduciary duty."

⁴ Freshfields Bruckhaus Deringer, (2005). 'A legal framework for the integration of environmental, social and governance issues into institutional investment'. Produced for the Asset Management Working Group of the UNEP Finance Initiative, p. 11.

See also the subsequent report 'Fiduciary responsibility: Legal and practical aspects of integrating environmental, social and governance issues into institutional investment'. A report by the Asset Management Working Group of the United Nations Environment Programme Finance Initiative, a follow up to the AMWG's 2005 'Freshfields Report' , July 2009.

⁵ UN Principles for Responsible Investment website: <http://www.unpri.org/about/>

⁶ Financial Reporting Council UK Stewardship Code website <http://www.frc.org.uk/corporate/investorgovernance.cfm>

⁷ This reflects terminology used in the 1999 amendment to the Pensions Act 1995, placing a requirement on trustees to declare in their Statement of Investment Principles "the extent (if at all) to which social, environmental and ethical (SEE) considerations are taken into account in the selection, retention and realisation of investments; and the policy (if any) directing the exercise of the rights (including voting rights) attaching to investments."

⁸ Harries (Bishop of Oxford) v Church Commissioners [1992] 1 WLR 1241

⁹ Draft submission to the consultation on charities and investment matters by the Joseph Rowntree Charitable Trust.

¹⁰ FairPensions, 'UK Fund Managers' Performance and Accountability on 'Extra-Financial' Risks' (November 2008), http://www.fairpensions.org.uk/sites/default/files/uploaded_files/documents/FundManagerRanking08.pdf

¹¹ EIRIS Foundation Charity Project, 'Are Charity Consultants Helping or Hindering the Development of SRI?' Discussion Paper, September 2009

¹² EIRIS Foundation and Charity Finance Directors' Group, 'Socially Responsible Investment: A Practical Introduction for Charity Trustees', June 2010, http://www.charitysri.org/downloads/key_publications/toolkit_for_charity_trustees.pdf, p. 10.

¹³ The survey, 'What is the UK public's opinion of charitable investments?', was conducted to gauge the public's opinion of charitable investments. <http://www.eiris.org/media.html#CharitySurv2011>

- 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.
- 71% agreed that large charities or their fund managers should be pro-active shareholders, engaging with companies to demand high standards of environmental and social responsibility from the companies they invest in.

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- 78% of people agreed that they would think worse of a charity if they knew it had funds invested in activities contrary to its specific work and values.
 - 84% of people agreed that charities should be fully transparent about their investments.
 - 87% of those surveyed either donated to charities and/or worked for them. Of these 89% were not familiar with the investments or investment policies of the charities they worked for, or donated to.

¹⁴ The Charitysri project website: http://www.charitysri.org/for_charities/case_studies.html
Charitysri.org was developed by the EIRIS/UKSIF Charity Project, a joint initiative between the EIRIS Foundation and UKSIF.

¹⁵ EIRIS Foundation and Charity Finance Directors' Group, '*Socially Responsible Investment: A Practical Introduction for Charity Trustees*', June 2010
http://www.charitysri.org/downloads/key_publications/toolkit_for_charity_trustees.pdf