

Investing in our Future: how charities can lead the way in responsible investment

This paper guides charity investors through the responsible investment landscape and provides tools to develop a policy to ensure their money is working for the world they want to see



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About ShareAction

ShareAction (Fairshare Educational Foundation) is a registered charity that promotes responsible investment practices. ShareAction believes that responsible investment helps to safeguard investments as well as securing environmental and social benefits.

About the Charities Responsible Investment Network

The Charities Responsible Investment Network supports charity and foundation investors to further their mission through responsible investment. It supports members by fostering a community of practitioners, providing in-depth research into environmental, social and governance (ESG) topics, delivering training tailored to Network members' interests and needs, and facilitating a range of optional engagement activities with selected companies and other entities across the investment chain.

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Executive Summary

Responsible investment is a key tool to help charities to further their charitable objectives. It is also an essential set of considerations for the long-term maintenance and growth of permanent endowments. Responsible investment allows charities to put their money where their principles are and ensure that their money is working for the world that they want to see.¹

The term initially described the integration of environmental, social and governance (ESG) factors into investment, with a strong emphasis placed upon providing financially material reasons to do so. In the five years since the first edition of this guide was created, we have seen growing awareness and acceptance that asset allocation and investment ownership decisions have ethical - as well as financial - implications, and a more mainstream acceptance that these choices must be morally justifiable. A responsible approach to investment recognises that long-term prosperity requires a move away from short-term profit as the only definition of value. It is a perspective that engages with the real-world social and environmental impact of all investment decisions.

Responsible investment can help endowed charities such as foundations to meet their charitable objectives, complement their grant giving, reduce investment risks, enhance and defend reputation and enhance risk-adjusted returns. Charities have the potential to be at the vanguard of deepening and developing responsible investment. They are actors within the investment system who are able to speak to 'the right thing to do' from a position of integrity as 'society's conscience', whilst also sharing the concern of all institutional investors for the importance of financial materiality in investment decision-making. As such, charities have played a significant role in the 'mainstreaming' of the responsible investment discussion across the investment industry. So, where next?

This report aims to help charities to gain a greater understanding of the landscape and the tools needed to write or redevelop a responsible investment policy. It will also support charities to provide clarity to their investment managers on their expectations for responsible investment. Whilst our focus is on UK-based charities, this report may be of interest to those outside the UK, as well as university endowments, family offices, and high net-worth individuals.

This piece builds on an earlier ShareAction guide (2014).² The responsible investment landscape has changed considerably over the past five years and this guide seeks to generate 'future-fit' recommendations for charity trustees. We explore changes to the regulatory environment with an awareness of the increasing press and public attention on charity investment practices and holdings.

The report is split into 2 parts:

- **Part 1** discusses what responsible investment means for charities, and outlines the regulatory landscape.
- **Part 2** provides practical support with creating, developing and consulting on a policy. It also deals with how to communicate that policy to asset managers and others, and ensure a clear implementation, evaluation and review procedure.

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Responsible investment is a key tool to help charities further their charitable objectives

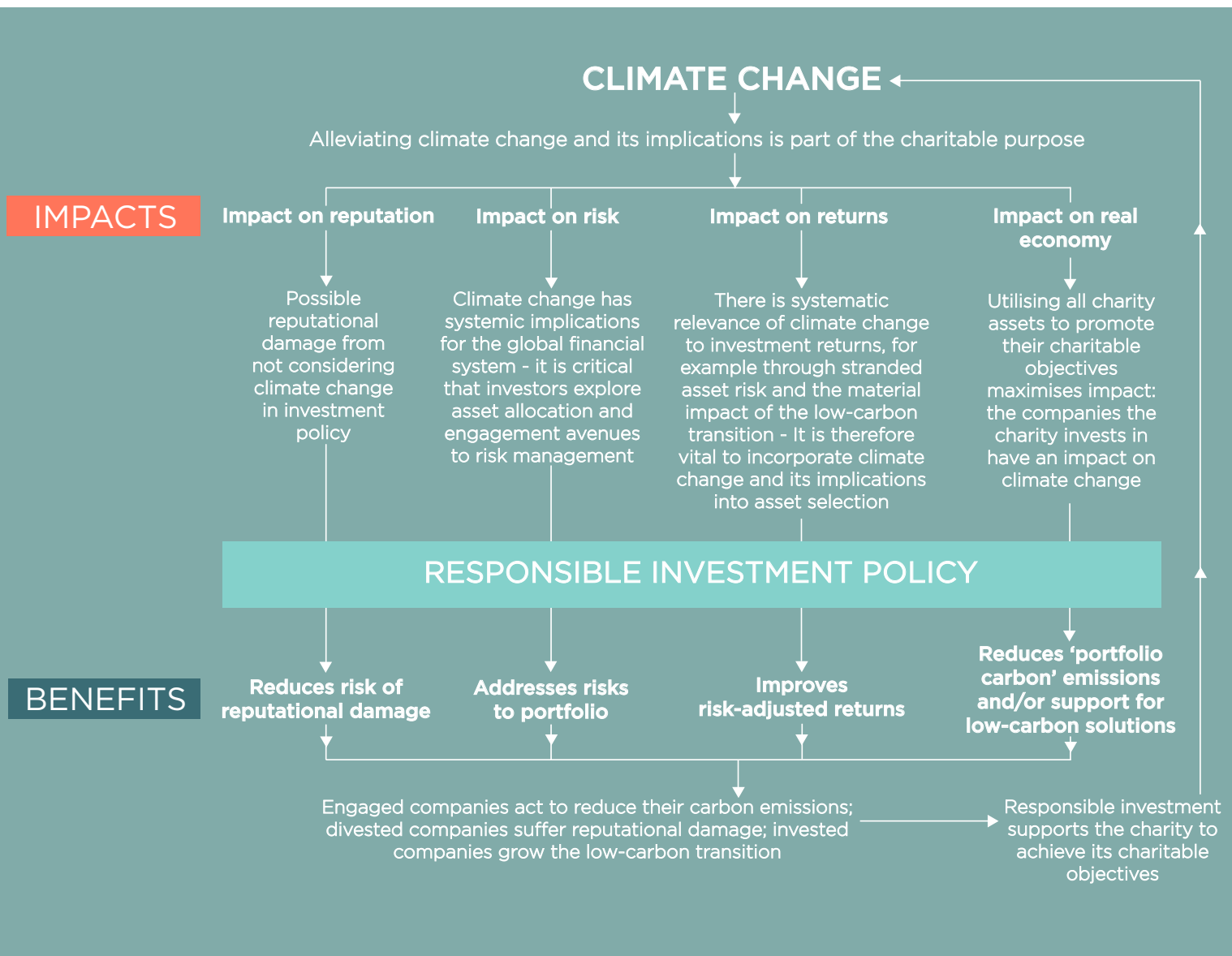
Part 1: The Responsible Investment Environment

This part provides an introductory overview of some essential information that you need to know prior to writing or re developing a policy, in light of the changing environment of responsible investment (RI). It outlines why charities should implement RI, explores the relationship between RI and performance, and outlines the current regulatory landscape in this area.

RI can help charities align their investment portfolio with their missions, enabling them to use a greater proportion of their resources to support charitable objectives. This is based on integrating ESG³ issues into investment decisions and engagement with those investments. Due to the extensive nature of corporate activities, even charities with a broad range of charitable objectives can align them with a carefully crafted RI policy.

Charity asset managers strive to secure a consistent and stable return in order to maintain income for use on charitable purposes (unless they are spending out). Alongside the alignment of investment and charitable aims, mainstream commentators increasingly recognise that integrating material ESG factors into investment process can have a positive impact on portfolio returns.

Figure 1: Dealing with climate change



RI recognises:

- a) **Impact on reputation:** the impact that a misalignment of charitable objectives and investment practice can have on the charity
- b) **Impact on return:** the impact that ESG issues can have on investee companies and eventual returns
- c) **Impact on risk:** the impact that ESG issues can have on the risk profile of investments across a range of asset classes
- d) **Impact on the real economy:** the impact that investment decisions can have on material ESG issues in the real economy (mirroring the values that the charity has addressed and aims to address through operational and granting activities).

These factors and ramifications can be seen in **Figure 1**, using the case study of climate change.

The purpose of an RI policy

Developing or reviewing an RI policy can fulfil a wide range of purposes.

- **Catalysing discussion** - Creating a policy provides a useful opportunity to discuss your charity's position on RI (and related issues such as impact investment, see Part 2) with the executive team, trustees and employees. This often requires a wider discussion about what your organisational values are, and how they translate into your investments.
- **Anchoring policy** - Developing and agreeing a policy makes it possible for your charity to hold current and future boards, directors, asset managers and other actors to account, ensuring that investment decision-making is long-term and in alignment with your organisational values.
- **Complementing charitable aims** - Effective RI should support your charity to fulfil charitable objectives by complementing grant giving and/or operational aspects.
- **Protecting and enhancing financial returns** - RI policies should be able to address the impact that ESG issues might have on their investment and portfolio returns. This policy should protect and enhance financial returns, particularly in the long term.
- **Guiding asset managers** - A policy should provide a clear framework for the asset managers of your charity, helping them to make investment decisions that best align with the charity's objectives and mission.
- **Enhancing reputation** - An effectively implemented policy can protect your charity's reputation by demonstrating that ESG and ethical issues have been considered in investment decisions, and that the charity has aligned investment with their values, avoiding accusations of hypocrisy.

RI and returns - a complicated picture

Asset owners and their managers have increasingly looked to incorporate ESG factors into the investment process, to improve risk-adjusted portfolio returns (as well as to achieve alignment between values and portfolio). This section explores whether there is evidence to suggest that considering ESG factors results in stronger or weaker portfolio performance.

Identifying causation between ESG factors and risk-adjusted returns is complicated. However, increasing amounts of academic research support a link that seems intuitive: for example, good governance practices could be used to identify well-governed businesses producing better shareholder returns. The same seems to be true for businesses that have a better record in managing environmental and social issues.^{4, 5}

The academic evidence seems to be supported by practical examples from the finance industry, e.g. with a number of ESG indices outperforming standard benchmarks. For example, Northern Trust constructed a series of portfolios that were weighted towards businesses that had a better record of managing ESG issues or where the management of ESG was improving. Both portfolios out-performed the relevant benchmark over 8 years.⁶

In summary, our brief analysis and review of the existing literature would indicate that, in general, increasing exposure to ESG factors in investment decisions rarely results in poorer risk adjusted returns and in certain conditions and sectors can result in out-performance. Evidence also seems to point to this being true across a number of different asset classes.⁷

On a connected and important note, fund managers are often overly focused on short-term returns linked to their own remuneration and retaining clients. Many charities are perpetually endowed – meaning that what happens in the next quarter, year, or even five years, is largely irrelevant. Perpetually endowed charities may want to consider a broader view that sustainable long-term returns can only be generated by markets located in fair societies and a healthy environment. Charities might want to actively think about investment practices that contribute to social justice or environmental solutions.

The regulatory environment for charities

As mentioned above, this report focuses on the UK picture for endowed charities. Current legislation and guidance, the critical part of which is the Charity Commission's 'CC14',⁸ permits charities to consider non-financial factors relating to their mission objectives in investment decision-making. Charities are thus free to strike an appropriate balance between securing financial returns that can be distributed to support that purpose, investing in ways that avoid negating that purpose, and investing directly to support their purpose. These approaches will involve range of expected financial returns. RI's ability to bridge the gap between 'finance-first' portfolios to pure grant-giving makes it an essential tool in addressing this balance.

Current regulations and guidance are clear that charities may conduct both social and responsible investment. However, there is a risk that this could cause confusion. Since CC14 is phrased permissively (i.e. charities *can*), this implies that RI is optional and charities may choose *not* to incorporate ESG factors.

Some charities that are active responsible investors argue that RI is:

- (a) A tool that all charities with reserves should treat as an opportunity to pursue their charitable objectives.
- (b) A board-level issue with regards to the management of both financial and reputational risks around investments that conflict with charitable objectives. The Charity Commission has written specific guidance on charity finance (CC25)⁹ and charity investment (CC14).¹⁰

These pieces of guidance are compatible, and we have therefore combined the documents to outline key points that relate to RI specifically:

Charities must:

- Follow any rules set out in the charity's governing document
- Consider any restrictions or additions to their general powers of investment
- Act within their duty of care, and their duty to act in the interests of their charity, when investing
- Take expert advice where necessary (in addition, they should consider whether to delegate the management of the charity's investments to a specialist)
- Consider the need to:
 - (a) make investments that are 'suitable' for the charity (the guidance does not explore what 'suitable' means), and to
 - (b) diversify their investments
- Have periodic reviews of their investments and asset manager, changing them if necessary
- Explain their investment policy in their annual report

Charities should:

- Consider whether it would be in the interests of the charity to adopt a responsible or ethical approach to investment - some types of investment could directly conflict with the aims of the charity, might alienate beneficiaries or supporters, or might not reflect its values and ethos.
- Agree the purpose of the investment assets, the level of risk and the investment time horizon that is appropriate for their charity, as well as any liquidity requirements and anticipated cash flow needs from the investments, and invest accordingly.

- Consider additional governance, environmental and social issues related to investee companies that could affect investment returns for specific investments.
- Have a clearly recorded and regularly reviewed investment policy, which must be explained in the trustees' annual report. This should contain the charity's position on responsible or ethical investment

Current regulation has nothing to say about where charities should start, and what they should do, in terms of their RI policy. That is therefore where this guide comes in.

Pension trustees - RI & Ethics

In autumn 2018, the Department for Work and Pensions produced new regulations that move towards increased transparency and accountability on RI for pension trustees. Although the new regulations do not apply to charities, they represent a significant development in the regulatory landscape.

The new regulations require pension funds to have policies on how they take account of ESG factors (within selection, retention and realisation of investments) and stewardship, including voting and engagement. Furthermore, pension funds must show how, if at all, they take account of 'non-financial matters' in investment, which should bolster charities' motivation for pursuing an RI approach. The regulations also put a strong spotlight on the risk management of climate change, and expand the concept of stewardship from the mention of exercising voting rights to engagement, which is a good sign for charity investors demonstrating that these investment practices are expected of fiduciary investors more broadly.

Part 2: Creating your Responsible Investment Policy

The process

This section outlines the process required for you to create an RI policy. Through this process, the content of the policy (outlined in the next section) will be drafted and refined.

Step 1 - Starting with the vision

Your RI policy should flow directly from your vision, mission and charitable objectives. Many charities see it as an additional ‘tool’ in delivering your theory of change. Your process should therefore begin with, and be driven by, your charity’s vision. This will help you to decide whether you should address a broad range of RI themes in your investment policy, or focus on the ones that relate most immediately to your charitable objectives. At this stage, you should consider the risks and opportunities of making asset allocation and engagement decisions in different thematic areas, and the ease of addressing these with available tools.

Step 2 - Engaging with the existing environment

Charities with assets will generally already have existing investment policies and asset managers. The introduction of a new policy will require you to adapt the existing processes within your charity, and construct a policy that reflects existing realities and processes. External regulation, the statement of investment principles, and your agreement with your asset manager(s) will all play a role in framing a new RI policy.

Step 3 - Building a consensus

Developing an RI policy may be driven by the trustees, but where this is not the case, then formal approval or support of trustees should be the initial stage. The benefits of having a policy are outlined in Part 1 (‘Why Have a Responsible Investment Policy?’), and might help in developing a business case. Developing an effective policy will require consensus and consultation across an organisation, reflecting the principles of transparency and accountability which are likely to be present in the policy itself. Consult with grant and programme managers, members and beneficiaries about how RI policies can better reflect the organisation’s ethics and purpose. This process will require careful framing to set participant expectations and ensure that you gain practical policy input.

Step 4 - Allocating resources

Before drafting your RI policy, it will be useful to determine the resources you wish to dedicate to developing and implementing your policy. Most charities have limited resources and expertise in RI. The Charities Responsible Investment Network helps charities to pool resources and knowledge and benefit from communication with other charities, educational resources and access to advocacy projects.¹¹

Step 5 - Working with partners

You will need to decide if it is appropriate to include asset managers or other external parties in the policy creation process. This may add value, but may also make the process longer and more complex, and potentially reduce the independence and flexibility of the process. Asset managers, investment advisors and peer organisations can provide useful expertise and guidance on formulating and implementing a policy, particularly as it is likely to affect how asset managers approach your charity’s assets and the engagement activities they undertake on your charity’s behalf.

Step 6 - Identifying implementation priorities







Once the policy has been drafted, finalised, and ratified by the board, the investment team needs to identify priorities for initial implementation, based on the resources that you are able to allocate. See Figure 2 for an overview of different RI themes commonly used by charities.

Selected Responsible Investment Themes

RI offers an opportunity to further your charitable mission, whatever that might be. This list of potential themes to explore is thus by no means an exhaustive over-view; indeed, charitable investors have frequently pioneered new areas of thought and action within RI (see for example Joseph Rowntree Charitable Trust's leading work around the ethics of investment in technology).¹²

We explore the ways that these themes can be made manifest practically in the next section.

Figure 2: Responsible Investment themes

 <p>Work</p>	<p>Living Wage Modern slavery Good work High pay</p>	 <p>Food/Health</p>	<p>Factory farming Health/drug pricing Gender</p>
 <p>Governance</p>	<p>Corporate Lobbying Tax Trade</p>	 <p>Social</p>	<p>Civil society space Human rights Social justice/poverty</p>
 <p>Climate/ Sustainability</p>	<p>Climate Water scarcity/pollution Biodiversity loss/extinction Pollution Air pollution</p>	 <p>International</p>	<p>International development Refugees/migration World heritage sites</p>

The Charities Responsible Investment Network is happy to provide assistance to charities at any stage of their journey into designing and implementing a RI policy. Members of the Charities Responsible Investment Network receive individual guidance, based on the processes outlined in this document and tailored to their unique characteristics and circumstances.

CASE STUDY



**Friends
Provident
Foundation**

Fair economy. Better world.

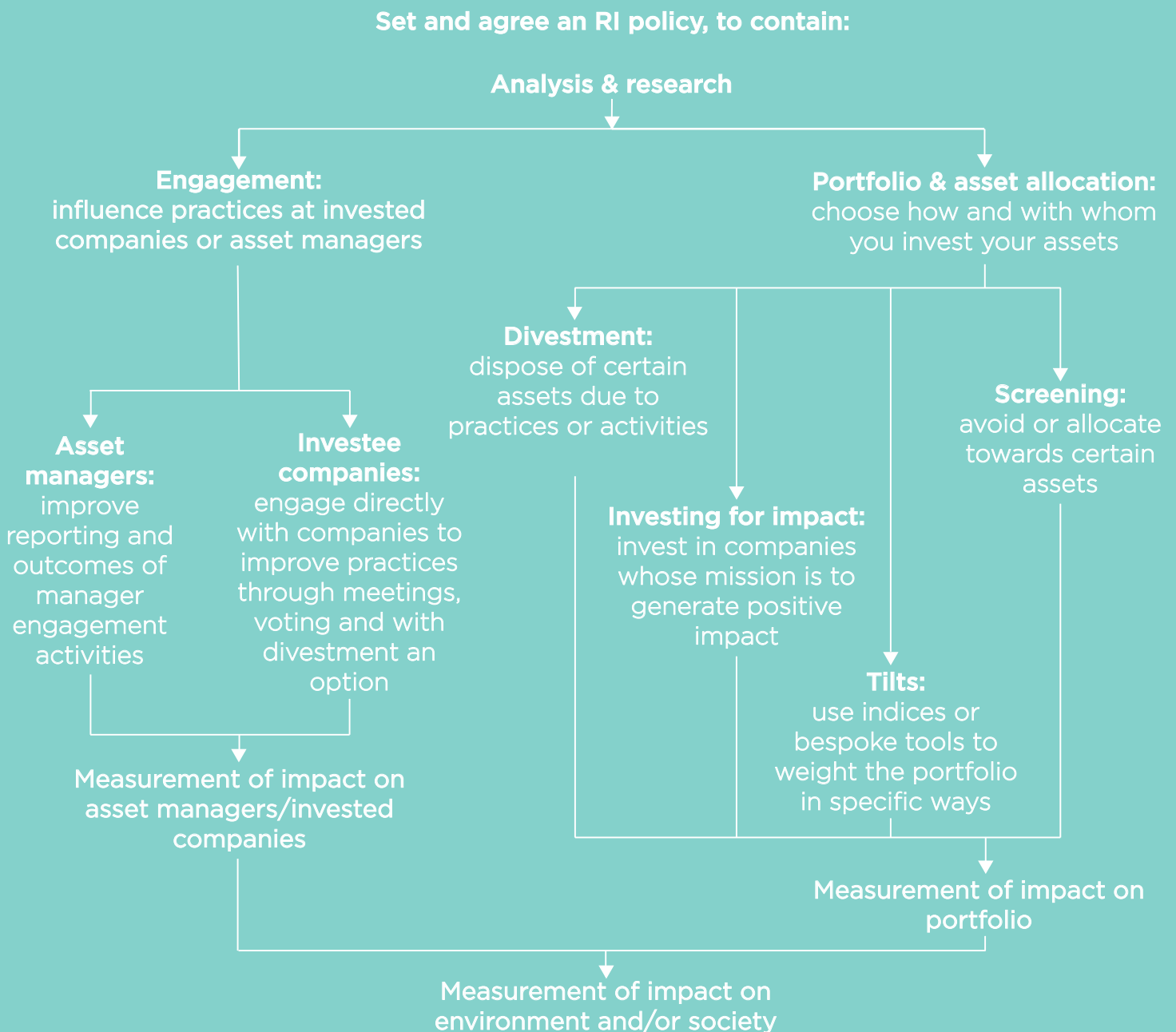
Friends Provident Foundation takes an integrated approach to their mission and capital base. They use their endowment as a tool for change, including through social investments and shareholder engagement. They believe that their investment decisions should contribute to their wider aims of building international, national and local resilience, and an economy that is fair, equitable and environmentally sustainable. They integrate this approach into their decisions about what to invest in, what not to invest in, how they exercise their stewardship responsibilities as a shareholder, and how they engage with the financial system as a whole. The Foundation has introduced a new thematic strategic approach that integrates grant-making, social impact investing, and mainstream market investment engagement.

The content

1. Approaches & tools

Having set the objectives and priorities of the policy, it will be useful for you to consider how you will achieve these using various tools or approaches. The terms used in Figure 3 are defined and explored in the text below.

Figure 3: Overview of RI approaches & tools



A. Analysis and research

This is the precursor to all other RI tools. A quantitative and evidence-based approach will enable you to start to explore both material risks and qualitative values. ShareAction's research papers on RI are a good starting point for this but you should also explore resources from other networks and bodies in Appendix 1. Fund managers increasingly undertake, or buy in research, on ESG issues.

B. Allocating your assets

Your RI policy is applicable for all asset classes, although your approach may be slightly different. For example, tilting, screening and divestment are all valid for fixed income such as bonds, but bond-holding of course does not entitle you to attend an AGM to ask questions. We explore fixed income engagement in some detail below ('Engagement in the corporate bond market').

Changing your asset allocation to engage with ESG considerations divides into three categories:

a) **Tilting** has the twin goals of reducing potential investment risk, and aiming to increase alignment with charity objectives. Tilting involves investing more in companies whose aims and practices align with the goal of your charity, and less in those who do not align, or contradict, those goals. Tilting is useful for controlling the alignment of holdings with your values, often without entirely omitting companies or sectors.

b) **Screening** involves the exclusion of part of the investment universe, based on specific criteria decided by your charity. A screen describes what your charity and its trustees want to exclude from the portfolio, and should include materiality thresholds for screening out companies which derive a certain proportion of their revenue or profit from the activity which is being screened against. Screening is generally undertaken to align investment holdings with the owner's ethical position, avoid reputational damage, and protect against stranded asset sectors or companies that are sensitive to risks not yet reflected in their value. Examples of the latter are the 'carbon bubble',¹³ and the price of horses following the introduction of automobiles.¹⁴ The presentation and communication of a screened approach to asset managers is a critical step for you to avoid exposure to 'screened out' sectors and activities through secondary holdings (see Section 2, Working With Asset Managers, below).

c) **Divestment** is a term used in two senses in contemporary RI. Firstly, and more traditionally, it refers to the introduction of a specific thematic screen in relation to a sector or company, which leads the asset owner to cease to invest. Secondly, the term is used in relation to movements such as the current fossil fuel divestment movement. Here, a major motivation is to tackle the causes of climate change by revoking the social contract for the fossil fuel industry to operate. Decisions on divestment (as defined in this second way) remain relatively rare and are often high profile. The goals of this second form of divestment is to generate reputational damage, which aims to affect the financial health of the company or sector in question, and/or to create an environment where public opinion makes regulation more likely.

Aside from some value in signaling to the market about a concern for investment responsibility, tilting, screening and divestment do not have a significant material impact on the wider financial system. This is because the securities covered in this sort of policy are traded on the secondary market, i.e. between investors. The share price, cost structure, and goods marketed by the company are not affected by the transaction, except perhaps in the unlikely case of an overwhelming proportion of shareholders attempting to sell simultaneously.¹⁵ However, it is without question that asset owners divesting from companies contributing to climate change, historically financing South African apartheid, or involved in manufacturing tobacco has contributed to generating debate and public engagement about the activities in a range of industries.

d) **Investing for impact:** Investing for impact, also described as social investment, is a developing field with a number of different definitions. The broadest definition is to invest with the intention to generate measurable environmental and social impact. There is a spectrum of expected returns, from market to a baseline return on investment. In our view, impact investing has three integral parts. The investor must have an explicit intention to generate a positive impact and sustainable financial performance. This positive impact is measured by utilising specific measures or benchmarks - both financial and impact-related. Finally, these financial and impact results go through a process of verification.

CASE STUDY



Polden-Puckham Charitable Foundation's Investment Policy excludes alcohol, arms, oil, gas and other fossil fuels, mining, pornography, supermarkets, tobacco, nuclear energy generation, large banks, government bonds and gambling from their investment portfolio. Additionally, it clearly states that investments in pharmaceuticals decisions, which fall under their 'grey area', will be made on a case-by-case basis. Because of their small size, they rely on their investment managers for engagement with companies on ESG criteria on their behalf. They seek to make informed decisions on the balance between excluding investments and engagement.

C. Engagement

This is the process of building dialogue with companies, industry bodies and actors within the investment space, regardless of your portfolio composition, holdings and returns.¹⁶ The motivation is to change the practices of these actors in line with the vision and consequent objectives of your charity.

There is a common misconception of a binary division between asset allocation decision and engaging with a company. However, screening or divestment is often preceded by engagement as an initial stage, followed by a period of 'grace' to allow the company time to change, and then escalation in engagement, and potentially then resulting in divestment. It is vital to ensure that this process of escalation is robust and based on rigorous timelines (discussed below).

a) **Company engagement** involves creating dialogue through which asset managers, trustees and/or charity officers can attempt to improve the ESG performance of a company.

Typical methods of engagement with companies include (ordered as a typical escalation pattern):

- Signing on to public letters raising issues of concern with a company or group of companies
- Writing directly to a company, arranging private meetings with board members and/or the investors relations team
- Public expressions of concern
- Asking challenging questions during the annual general meetings to the board - ShareAction's AGM activism project may be useful here.¹⁷
- Following up on these questions
- Working in partnership with other asset owners to build pressure
- Filing shareholder resolutions - ShareAction's Guide to Shareholder Resolutions might be useful here.¹⁸

We suggest that you include a section in your RI policy covering how you plan to engage regarding specific issues, both as a staff/trustee team, and through your asset manager (see below).

b) **Policy advocacy** involves investors lobbying policy makers on issues that are relevant to their investments and ESG priorities. Regulatory change may be a prerequisite to achieving your goals as a responsible investor. This could be done through making submissions to relevant consultations, or communicating directly with policy makers through letters and meetings. Policy engagement by investors is increasing, nationally and globally.¹⁹

c) **Voting** is the process by which shareholders exercise their voting rights in companies they hold public equity in. They can use their vote to signal support for bringing a company's practices in line with their objectives as an investor.

In practice, many charities are not able to direct how their manager votes, either because their asset managers do not accommodate this or because their investments are in pooled funds, which are subject to the managers' house voting policy. As our research on proxy voting shows, most asset managers effectively 'out-source' voting decisions to the main two proxy voting providers (ISS and Glass Lewis).²⁰

In many cases, those asset managers who are most transparent about their voting are also those who make the most effort to consider ESG factors when voting. In order to vote in line with your charity's stance on RI themes, you may wish to develop guidelines for voting your shares and to ask managers whether these can be reflected in how your shares are voted. Some managers will accommodate this even in pooled funds, although this service may only be available for larger clients.

At an absolute minimum, you should request that your fund manager reports promptly on voting decisions, and outlines the rationale for any controversial votes. In meetings with your managers you should challenge why votes were cast in certain ways, especially if this clashes with the manager's claims about RI.

CASE STUDY



Sweden's public pension fund, AP7, has taken a dedicated approach to engaging with (and in some cases, divesting from) companies in its investment portfolio which it considers to be breaching the goals of the Paris Agreement either in their business models or policy lobbying activities. This approach is also complemented by targeted company engagement involving 'impact-focused' dialogue with over 100 companies on a range of topics ranging from oil-exploration in the arctic, to lobbying activities, and phasing out fossil fuels from utility companies. AP7 is also active in co-filing strategic climate resolutions and also raises climate issues at AGMs.

Engagement in the corporate bond market

Corporate bonds are often important parts of a balanced portfolio of assets for charities. However, RI has tended to focus on equities, due to the different ownership rights and market structure. ShareAction recently undertook a piece of research reviewing the ability and enthusiasm of corporate bond investors to engage with issuers to promote better practice.²¹ The research, based on interviews with 22 bond market professionals, made a number of findings.

On one hand, these investors broadly recognise the materiality of ESG issues across issuers of corporate bonds and are increasingly incorporating these factors into asset selection and portfolio construction. However, they are then are not willing to take forceful action to promote better alignment with the Paris Agreement or to promote other ESG issues. Major bondholders are thus focused on mitigating portfolio-level climate risk but are not yet willing to commit to action on climate change itself. Charity asset owners can do a great deal to signal interest in the developing area of forceful fixed income stewardship, through discussing expectations for engagement in their RI Policy.

2. Working with asset managers

Both to address a lack of internal capacity, and to access expertise, most charities employ one or multiple asset managers to implement their investment and RI policies. Drawing on research on RI leading practice, and consultation with Charities Responsible Investment Network members, we compiled a short document 'Improving the Conversation: What Charity Investors Expect from their Asset Managers'.²²

The piece aims to:

- **Provide criteria** for selecting new managers;
- **Act as a guide** or set of principles to improve the outcomes of conversations between charity investors and their current asset managers;
- **Offer a framework** of core expectations for internal conversations and discussions with advisors and consultants;
- **Send a signal** to the market regarding the standards expected.

The focus of the piece is public equity management, but the core principles are relevant for all asset classes. This is included as a tear sheet, found at the back of this report.

Ideally, asset owners and managers should operate symbiotically, striving for the same outcomes. Finding manager/s and teams with a strong value alignment to your charity is an essential and often under-explored step in achieving your intended RI outcomes. Charities should look for asset managers that understand them and share their values – and which are willing to undertake both investment restrictions and value-led engagement projects which fit your concerns. This can of course be followed up with a contractual agreement, but a basic overlap of values is necessary to ensure good quality implementation. A higher level of customisation may result in higher fees which charities should monitor.

Information about the RI practices of different asset managers may be found on their own websites and is often requested in the Request for Proposals. You should ensure that you request information about their RI strategies, stewardship practices, and their underlying values. ShareAction publishes regular asset manager surveys and rankings. We also publish bespoke annual reports for members of the Charities Responsible Investment Network, to get 'under the lid' of publicly available data and submissions.

Effective and regular communication will allow you to track your asset manager's performance and practices, and to ensure that your voice is heard in decisions made about how your money is invested. You may wish to set out clear guidelines in your RI policy covering reporting, voting, engagement, escalation and governance. CRIN's 'Improving the Conversation' research (see end of this report) includes a series of practical examples of this process. For example, it includes guidance that managers should 'Vote to support all independent ESG resolutions, providing a published rationale to explain if any are not supported ('comply or explain' approach to voting)'.

CASE STUDY



In 2016, Joseph Rowntree Charitable Trust met with their managers as a group to discuss the significant gender imbalance within the fund management industry. They had an open and rich discussion and, since then, have continued to work with their managers to develop impactful targets.

3. Reporting and communication

In addition to improving your communication with asset managers and ensuring that your expectations around them are met, you may also wish to establish a process for communicating about your RI activities to a wider audience. This could include updates on screenings, new investments and managers, voting and engagement with companies, organisations and policy makers, and how these activities contribute to your mission. You will need to consider who needs to know how the policy is working, what they need to know, and the best ways to report or communicate. Key recipients of these reports should be:

- **Trustees:** to report on the extent of effective implementation of the RI policy.
- **Staff:** to raise awareness of the impact that the RI policy has upon charitable objectives.
- **Beneficiaries and the public:** to outline the positive reputational benefits of an effective RI policy.

CASE STUDY



Esmée Fairbairn Foundation produces a regular written update to board and investment committee on recent news items which may be of interest. It has generated good internal conversations.

4. Implementing and evaluating the policy

Your RI policy should be a 'living document' – continually open to discussion and potential amendment. To facilitate this, it is helpful to write an implementation plan to supplement the core policy document. This should:

- **Identify roles** within your team and their responsibilities in terms of both implementing and reviewing the policy.
- **Provide an overview of the resources** that you initially allocated to delivering the RI policy (e.g. staff time, financing for external support, bespoke research), and create a space to track their use.
- **Contain operational goals** for their investment-related staff and/or trustees, including milestones and deadlines. This makes it possible to review progress at executive and board levels, as well as to periodically discuss the impact of a given policy.

During the drafting period, it will be useful for you to discuss how your RI policy relates to other policies, such as the general investment policy and complementary policies such as an environmental policy.

5. Reviewing the policy

As RI among charity investors matures, many charities are beginning to rewrite their original policies. This frequently occurs after a period of implementation, and (in some cases) formal evaluation shows some room for potential improvement.

To ensure that your policy remains relevant and current, you could consider including text to determine:

- How often the policy should be reviewed?
- Who should provide input into the review?
- What feedback to seek in the review process?
- Who is responsible for making changes to the policy after the review process?

Charities may want to review the extent to which their asset manager's asset allocation and investment practices have been properly aligned with the guidance around RI provided in their policy.

CASE STUDY



Lankelly Chase's objective is to use their investments to help change the system. Committed, active stewardship is a necessary condition for long-term wealth creation based on mutual value. They measure more than short-term financial performance: longer term thinking and impact measurement are key. Their stewardship is a process of structured engagement with companies through their managers and other investors to help achieve their objectives. They seek open and reflective relationships with their investment managers. The Social Investment Policy is a living document that is reviewed annually and will continue to evolve as they learn more about how to be an effective investor.

Concluding Remarks

In 2014, when our ‘Your Money, Your Mission’ guide was released, the phrase “responsible investment” was largely understood to cover management of ESG risks and value-based screening.

Yet today, charities reviewing their RI policies are often struck by the potential to add ambition to their previous policy, and the extent to which RI has become increasingly mainstream. Simultaneously, expectations on institutional investors to invest responsibly have increased as public awareness of the ‘real world’ consequences of invested assets has grown. In the UK, there is now formal legal recognition that taking account of ESG risks is part of fiduciary duty.

Regulatory changes, public perceptions and evidence around ESG performance means that RI is no longer a topic that charity investors can ignore. There is also a growing cynicism about the ‘tick-box’ approaches and ‘green washing’.

Charity investors need to recognise these changing dynamics. RI is an opportunity for charity asset owners to maximise their impact, as the central part of the spectrum that ranges through grant giving, investing for impact, the incorporation of ESG factors into investment practices, and the financial priorities to maintain the charity in perpetuity. Fiduciary investors acting on behalf of others are required in law and practice to operate in the interests of those to whom they owe a duty of care. As is now legally recognised, protecting value by taking account of ESG risks is part of this duty. To call them ‘responsible investors’ for doing this much - for just doing their job - does not make sense. It is time to assert that a responsible institutional investor is one that takes responsibility for the *impacts* of their decisions.

The news and business agenda is increasingly dominated by mega-trends such as bioethics, the ‘just transition’, the changing nature of work, and climate change. RI is fracturing out of the traditional siloes of environment, social and governance concerns. As governments and society adapt to these changes, there will be important implications for investors and asset owners. It is our hope that this guide equips charitable investors to make strong and sustainable decisions in this changing world.

Improving the Conversation: What Charity Investors Expect from their Asset Managers

This discussion paper draws upon recent quantitative and qualitative research on responsible investment leading practice, and was developed through consultation with members of the Charities Responsible Investment Network.

The purpose of the document is to:

1. Act as a guide or set of principles to improve the outcomes of conversations between charity investors and their current asset managers;
2. Provide criteria for selecting new managers;
3. Offer a framework of core expectations for internal conversations and discussions with advisors and consultants; and
4. Send a signal to the market regarding the standards expected.

This document is intended neither to be a fixed requirement or 'red line' for asset managers, nor to supersede existing responsible investment policies. It is structured for use both in relation to overall asset manager policy, and on a fund-specific basis. The primary focus is public securities.

We hope that charity investors use this paper to improve the quality of conversations with their asset managers. We firstly cover disclosure and transparency, core aspects of the responsible investment process, with a focus on voting, engagement and escalation. We then explore leading practice among asset owners.

Disclosure and practice expectations

Proxy Voting

Voting decisions on issues such as pay, climate, board structure and auditor re-appointment are important pieces of evidence for asset owners on asset manager commitment to environmental, social and governance issues. These decisions are clear indications of organisational commitment to challenging management and promoting best practice. Asset managers should:

- Provide searchable public databases on all voting decisions, within three months following the vote;
- Explain through a specific policy the use of 'abstentions' and/or 'special exemptions' during the last 12 months, and disclose the annual percentage of votes where abstentions or special exemptions were used;
- Publish rationales for voting decisions on all controversial votes, and on all abstentions and special exemptions;
- Vote to support all independent ESG resolutions, providing a published rationale to explain if any are not supported ('comply or explain' approach to voting); and
- Accept investor directed voting in pooled funds.

Engagement and escalation

Engagement and escalation on ESG issues is often poorly defined and presented in 'stories' rather than as an integrated process and framework. We are looking for more professional and standardised processes. Asset managers should:

- Outline priorities for engagement by topic, companies, sectors or asset classes, and provide a rationale;

- Provide a clear policy around the escalation of engagement – how and why this might happen and what is the ultimate tool, e.g. divestment, voting against board re-election; and
- Publish annual evaluations of the engagement and escalation process and outcomes, using concrete case studies as well as quantitative overviews.

Holdings

Asset managers should:

- Publish full holdings to clients – annually or upon request; and
- Demonstrate incorporation of material ESG issues into investment decision making, asset allocation and portfolio management across all asset classes.

Governance

Asset managers should:

- Have a clear public policy on corporate governance, engagement and ESG issues, including outlining the process of client input;
- Publicly disclose who approves the corporate governance policy and when reviews occur; and
- Outline how the impact of investments on society and the environment are considered in developing future strategy.

Leading practice

Our recent surveys of how leading asset owners, insurers and asset managers have responded to climate change and its implications have shown that there is no single ‘best’ approach to the integration of this major material ESG issue into investment management. In this section, we highlight approaches that leading fund managers have demonstrated across the ESG domain, and for which we feel fund managers should be able to provide examples.

Forward planning

ESG issues such as the physical impacts and transition to a low carbon economy have material impacts across assets and portfolios. Explain how you have incorporated material ESG issues, particularly climate change, into risk and scenario analysis.

Fee transparency

Clients are looking for managers to be proactive about fee transparency, in line with standards such as the [LGPS Code](#). Provide clients with a comprehensive account of mainstream fund fees and charges.

Co-filing resolutions on ESG issues

This area might prove difficult for some, but plays a part in the development of engagement policies and the escalation of issues. What are your plans and strategy for exploring this area?

Explaining collaboration

As clients, it is difficult to differentiate ‘talking shops’ from effective collaborative actions. To help us understand your collaborative engagement, outline three key collaborative initiatives, the nature of your involvement, and the results.

Matching expectations

How have you ensured that the expectations and demands made on companies in which you engage are reflected in your own boards and senior leadership?

Appendix 1: Overview of key RI organisations - who is who

Charities can enhance the impact of their engagements and the quality of their decisions, as well as to pool resources, by collaborating with other responsible investors. This may be done by joining networks and initiatives.

You may wish to set out a position on collaboration with other like-minded investors in your policy.

- **The Charities Responsible Investment Network** is an independent body supporting foundations and other charitable organisations with investments to further their mission through RI. Network members engage with their investee companies, investment managers and policy makers on varied issues.
- ShareAction also provides the secretariat for the **European Responsible Investment Network**, a network of civil society organisations across Europe. ERIN brings together charities with an operational interest in promoting and campaigning around RI.
- **The Church Investors Group** represents institutional investors from Church denominations and church related charities with the aim of encouraging responsible business practice. They do this through engagement with company management and sharing information and views on ethical matters related to investment.
- **The EIRIS Foundation** provides free and objective information on ethical finance and corporate activity to other charities and the public. Its ultimate aim is to help create a financial and corporate system that will drive the transition to a more sustainable world.
- **The Charity Investors Group** is a forum of charities and asset managers for investment debate with the common interest of promoting a greater understanding of investment related issues.
- **The Social Impact Investors Group** is the go-to space for foundations to learn about, and find, social investment opportunities. It exists to support foundations interested in starting or currently undertaking social impact investing, covering impact investment specific topics. This network is hosted by the Association of Charitable Foundations, and works closely with Big Society Capital.

CASE STUDY



Polden-Puckham Charitable Foundation are members of networks and initiatives such as the Charities Responsible Investment Network (ShareAction), the Church Investors Group, the Institutional Investor's Group on Climate Change (IIGCC), the Association of Charitable Foundations (ACF) and the Environmental Funders Network (EFN). These networks are seen as opportunities to collaborate, develop skills and share knowledge around RI.

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About ShareAction

ShareAction (Fairshare Educational Foundation) is a registered charity that promotes responsible investment practices by pension providers and fund managers. ShareAction believes that responsible investment helps to safeguard investments as well as securing environmental and social benefits.

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