

EIRIS Foundation Response to Charity Commission Consultation on Responsible Investment

The EIRIS Foundation is pleased to respond to the Charity Commission's consultation on its Responsible Investment guidance: <https://www.gov.uk/government/consultations/charity-responsible-investment-guidance>. We welcome the Commission's efforts to clarify and update the existing guidance and to acknowledge some of the current issues. However, overall, we feel the proposed changes do not adequately reflect:

- current best practice and innovations in the responsible investment landscape.
- societal expectations and need with regards to, amongst other issues, the climate emergency and the ways in which investment can be part of a solution.
- the need, and desire, from charities for forward-thinking guidance that is, at the very least, aligned to other governmental developments around responsible investment (such as current pensions guidance on climate).
- the degree to which thinking around responsible investment and ESG has moved on in recent years dispelling the myth that there is an either-or decision between financial returns and responsible investment.

In our previous response to the Commission's call for views on this topic we indicated that although the current guidance doesn't prohibit charities from taking social, ethical and/or environmental considerations into account with regards to their investments it also does little to encourage them. It is our belief that charities should be taking their charitable objectives and their public benefit requirement into account when setting investment policy and making investment decisions. The public benefit principle would normally require you think about whether your fundraising activities or the operation of any other charity asset were causing negative harms. It seems to us that investments should not be somehow exempt from the same scrutiny and challenge. We don't think that the proposed changes generally address this point adequately.

Another general concern is the suggestion that endowed charities should face more hurdles in adopting sustainable/responsible approaches. This is hard to reconcile with the fact that their time horizon is nearly infinite and yet the government expects more of pension funds who have (relatively speaking) shorter time horizons on grounds including the long-term financial wisdom of doing so. In particular pension trustees are being required to report on TCFD (Taskforce on Climate-Related Financial Disclosures), and there are plans going forward to give trustees a clearer role in determining and implementing voting policy. There is also on-going consultation about how trustees should consider financially material social factors in their investment and stewardship activities. Pension funds and other long-term investors have been an important part of the creation of the UK Stewardship Code 2020 whose principles of good governance, including the responsibility to address systemic and market wide issues such as climate, seem highly relevant to larger charity investors and the managers of the funds of smaller charities but don't appear to have been addressed in this exercise.

Consultation questions

Question 1

As a result of reading this draft guidance, how clear are you about the duties and good practice that apply to decisions about a charity's financial investments, whether or not the charity adopts a responsible investment approach?

The draft guidance doesn't make it clear enough that good practice would be for charities to see their charitable assets and investments as part of the set of tools they have to achieve their mission and objectives.

The proposed guidance seems to pit financial returns with responsible investment and doesn't make it clear enough that these do not have to be either/or considerations.

In our response to the Commission's previous RI 'listening exercise' we stated that it would be helpful for charities to be given clear guidance on how the public benefit test applies to investment activities, including in relation to the further requirement to ensure that any harm is a minor consequence of the way the charity is operating. The options that trustees have in this field have developed significantly, particularly with the development of responsible investment in the last 10 years. The proposed updated guidance doesn't really address this point.

Question 2

As a result of reading this draft guidance, how clear are you about what a responsible investment approach is?

The draft guidance doesn't make it clear that Environmental, Social and Governance 'ESG' integration is part of a responsible investment approach AND this is not distinctive or separate from what is referred to as 'financial investment'. The draft guidance doesn't seem to make any consideration for the fact that all investors, especially long-term investors' face systemic risk which should be a consideration, and that currently there is widespread acceptance that part of this systemic risk includes ESG issues such as climate change, biodiversity loss and others.

Question 3

Is the phrase 'responsible investment' an appropriate term for the approach to investing in line with a charity's purpose and values?

We believe that it is a useful term, but that it is normally understood more widely than appears to be the case here. At times the guidance seems to describe responsible investment as being the same as ethical investment, mission-aligned or programme-related investment but treats the understanding of the impact of ESG factors on investment outcomes as something different. The draft guidance also seems to suggest that responsible investment is also entirely optional which we find extremely problematic considering that responsible investment should be part of any good and prudent investment strategy.

The Commission might find it helpful to look at the definitions that emerged from the BSI PAS 7341 (supported by BEIS) which saw responsible investment as being investment that takes account of all material ESG and other risks in pursuit of long-term sustainable returns and sees sustainable investment as going a step further by pursuing specific sustainability goals. For the purpose of this guidance, those sustainability goals might be defined by charitable purposes.

Whatever terminology is used, we believe it would be useful for the Commission to be clear that for charities the key practical areas that they should have a considered approach to are: negative screening; positive focus (thematic investment or positive preferences); high impact social investments; voting, engagement and stewardship opportunities and ESG integration (understanding the impact of ESG factors on investment performance).

Question 4

How confident would you be, as a result of reading this draft guidance, that adopting a responsible investment approach is a valid option?

The draft guidance does make it clear that adopting responsible investment is a valid option but does make it seem as though it is an additional component rather than an integral part of best practice some aspects of which can be a requirement. It is understandable that the Commission does not wish to dictate responsible investment policies for individual charities, but in places the draft guidance appears to suggest that even considering responsible investment or ESG considerations is entirely optional.

Question 5

In the section ‘Check if extra rules apply’, we say that there are some situations where a responsible investment approach can be taken only if at least one of five tests is met.

As a result of reading this draft guidance, how clear are you about when these tests are relevant to the decision to take a responsible investment approach?

This section seems to place an incorrect emphasis on there being a financial detriment to responsible investment. The five tests should be expanded to include at least cases where

- the approach is intended to increase the long-term value of an individual investment or a portfolio as a whole
- the approach offers the charity opportunities to advance its purpose by influencing individual companies or the general understanding of good governance and corporate responsibility in ways that have a practical impact in its field of work.

We also propose in our more details comments below some general considerations that any long-term investor (such as an endowed charity) should take into account.

Question 6

Do you have any other comments to make on the draft guidance?

One of the findings from the aforementioned ‘listening exercise’ indicated that a lack of practical guidance for charities on RI is an issue and this doesn’t seem to have been addressed in the proposed changes.

As they stand, the draft guidance, although providing some useful points of clarification, is unlikely to have to have much of an effect on how charities currently approach RI. We believe that, unless it can be strengthened, this would be a missed opportunity for charities to take advantage of the opportunities that responsible and sustainable investment offer to pursue their purposes more effectively, and a failure to keep pace with the development of responsible investment in the marketplace amongst other long-term investors.

We outline some more detailed comments, with suggested amendments in the table below:

Section	Proposal for new/amended guidance	Rationale/comments
2	<ul style="list-style-type: none">• Whether there are business activities that would conflict with the purpose of your charity and should be avoided	The practical conflict example mention in the legal underpinning
	<ul style="list-style-type: none">• Whether a responsible investment approach would provide opportunities to advance your charities purpose and values	Frames the decision in terms of the benefit to the charity rather than the present “optional” framing

2.1		The examples are very useful and welcome as is the clarity that a responsible investment approach does not depend upon the purpose of the charity as long as it is in the best interests of the charity
3.1	<ul style="list-style-type: none"> Monitoring the investments and decisions made by any investment manager to ensure that they remain aligned with your approach 	Consistent with the “know what you own” approach proposed in section 6.6 and related points in section 4.2
		The statement that the commission is unlikely to have concerns about your investment approach as long as you have taken the three steps listed is helpful and welcome
3.2	<ul style="list-style-type: none"> Identify any risk of detriment or harm to your charities beneficiaries or the public in general that might arise from the investments made and consider how those risks might be minimised or avoided 	Based on the Commission’s public benefit guidance and the growing availability of strategies to reduce ESG risk in the marketplace including through the Stewardship Code 2020 and SFDR requirements
3.2	<p>Add at the end</p> <p>Charities of all types should have regard to these principles as an element of their general public benefit obligation and as good practice.</p>	The fact that these elements have been identified as part of good corporate citizenship in the relevant legislation for companies helps to make the case to apply the same principles to charities as part of their public benefit obligations, and to maintain public confidence in the charity sector in general
3.3	It would be helpful for the commission to indicate that it would not generally object to changes being made to governing documents in this regard to provide trustees with clarity if they were following investment approaches of the type given in the guidance examples.	The commission has already indicated in Section 3.1 that it would be unlikely to have concerns about investment approaches following the three principles set out
3.4	The section should become “Particular considerations for permanent endowments”	It should not be suggested that there are extra barriers for those with the longest timescales, in fact there is a stronger case for considering a number of ESG factors
3.4	<p>Trustees of permanent endowments should</p> <ul style="list-style-type: none"> Identify any long term ESG trends that will affect their endowment and what steps may be open to the charity to address these challenges, invest in solutions and prepare their investment portfolio for different future scenarios 	These are the sort of considerations that have led the government and regulators to create the UK Stewardship Code and take action on pension fund investment requiring TCFD reporting and to develop proposals for greater trustee

	<ul style="list-style-type: none"> Consider what Stewardship activities they might engage in or expect of their investment managers to advance the long term interests of their charity and its purpose <p>See also comments above on the five tests</p>	<p>involvement in voting policies and consideration of material social factors to benefit their investments in the long term. Endowed charities have social purposes in addition to long term time horizons which makes this even more relevant</p>
4.2	<p>“Can” should be replaced by “Should” in which case the second point might become “consider” any reputational risks and the last point might become</p> <ul style="list-style-type: none"> Consider the relevance of how companies or investment managers disclose their ESG risk management process and how those are verified 	<p>Trustee are told they “should” consider a range of other risks in Section 4, so downgrading ESG risks to “can” would appear to suggest that trustees can ignore the financial impact of ESG factors such as climate change on their investments, or that they can adopt an ESG policy without regard to whether their investment manager implements it. Requiring consideration of these matters, would not impose any particular conclusion on trustees but would ensure good process.</p>
4.3	<ul style="list-style-type: none"> The types of investment it wants to make <i>including any responsible investment requirement related to positive or negative screening, high impact social investments, voting, engagement and stewardship, the integration of ESG factors in investment judgements or the charity’s public benefit obligations</i> Reporting requirements for investment managers, <i>including reporting on their responsible or sustainable investment activities and approach</i> 	<p>This section needs to reflect the examples and other guidance given in the rest of the document to support trustee decision making better and ensure that the investment policy is clear for all parties, given its central role in good process. It should refer explicitly to the underlying approaches behind the examples given in in Section 2.1 and the rest of the guidance.</p>
5.3	<p>Replace “its ethical stance (if any)” with</p> <ul style="list-style-type: none"> <i>It’s approach to responsible or sustainable investment including positive or negative screening, high impact social investments, voting, engagement and stewardship, the integration of ESG factors in investment judgements and the approach it takes to the public benefit obligations on charities</i> 	<p>The guidance should be strengthen here to make sure that trustees are aware of how pooled funds might help them implement their responsible or sustainable investment policies</p> <p>Our recent report on Charity Pooled Funds and Responsible Investment found that a number of charity pooled funds have no responsible investment policy and that a number of funds with policies don’t apply them to indirect holdings. We also believe charity pooled funds should</p>

		be subject to TCFD requirements to make climate related financial disclosures
6.6	<ul style="list-style-type: none"> knowing what the charity is invested in <i>and what stewardship activities are being undertaken on its behalf</i> 	The addition of “know what you own” in the guidance is welcome, and this should be extended to include knowing how voting and other rights or opportunities are being used.
8.9	<ul style="list-style-type: none"> Shareholder activism needs to be related to the charities aims, <i>the long term performance of the company, or reducing any public detriment or harm</i> 	The guidance should not exclude stewardship activities intended to increase the long term value of an investment held by a charity, and ESG engagement & voting now frequently provide an opportunity for investors to reduce the potential harms described in the Commission’s public benefit guidance