Charity responsible investment guidance

Charities Aid Foundation response to the Charity Commission's open consultation

CAF Charities Aid Foundation

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May 2021

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1. About CAF

1.1 The Charities Aid Foundation is among the UK's largest foundations and works with partners across industry, government, and individual philanthropists to ensure vital funding reaches charities around the world. This enables us to deliver on what we are strive to be all about – which is to play our part in providing a fair and sustainable future for all.

1.2 We work to stimulate philanthropy, social investment and the effective use of charitable funds by offering a range of specialist financial and philanthropic services to charities and donors, and through advocating for a favourable public policy environment. In 2019/20 the Charities Aid Foundation distributed a record £702m to charities in the UK and 110 countries around the world.

1.3 CAF's research team publishes landmark reports such as UK Giving and the World Giving Index, and has provided analysis and insight on the impact of Covid-19 on the charity sector. Through our policy research and analysis, we work to better understand the macro trends affecting philanthropy and the work of charities. We also campaign on a range of issues affecting charities and civil society. We are, for example, part of a coalition of charities and umbrella bodies calling for a Gift Aid Emergency Relief Package.

1.4 CAF offers a range of investment funds and services exclusively to charitable investors through its wholly owned subsidiary, CAF Financial Solutions Limited. We combine our sector knowledge gained through many years of working with not for profit organisations and philanthropists with that of carefully selected investment industry experts, to create and offer our solutions.

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2. About this consultation

2.1 The Charity Commission is consulting on the clarity of their draft revised guidance about adopting a responsible (or 'ethical') approach to investing charity funds. The guidance is relevant to charities in England and Wales, whether or not they are registered with the Charity Commission for England and Wales.

Consultation questions

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As a result of reading this draft guidance, how clear are you about the duties and good practice that apply to decisions about a charity's financial investments, whether or not the charity adopts a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

3.1 Overall clarity

3.1.1 The duties and good practice laid out in the guidance are clearly described and the draft guidance is also shorter. This will make it easier for trustees (the vast majority of whom are volunteers without expert financial knowledge) to read and understand, which is clearly positive.

3.1.2 The guidance makes it clear that trustees have the overall responsibility for planning, managing, and reviewing their charity's investment approach - even in cases where day-to-day responsibility for decision-making is delegated to an investment manager. It also makes it clear that trustees need to take an active decision about whether to adopt a "responsible investment approach" (i.e. investing in order to further the charity's mission directly, rather than solely with an emphasis on financial return) and to record this accordingly.

3.2 Perceived trade-offs between approaches

3.2.1 The guidance remains neutral on the question of whether trustees should have a duty to align their investment approach with their wider mission. This is broadly right, as the final responsibility must lie with trustees, and they must have the freedom to make decisions that best suit the particular needs of their organisation. However, there is perhaps an opportunity to be more ambitious within the revised guidance; and to go further in shifting emphasis so that responsible investment is positioned as the norm rather than the exception for charities (in line with existing charity investment trends and with trends in the broader investment market).

3.2.2 The language used and the ordering of the examples and options are important here, as these can help alter the emphasis whilst retaining the guidance's underlying neutral stance. In a behavioural sense, this could shift the perceptions of trustees and their advisers from a position in which responsible investment is seen as something one has to actively opt in to, to a position in which it is seen instead as something one has to actively opt-out of. The same freedom would

thus be available to trustees in terms of making choices about how to invest, but with different starting assumptions and with an onus to explain why a responsible investment approach *has not* been taken rather than why it has.

3.2.3 For example, the choice architecture of the guidance in point 2 of the guidance could be altered so that responsible investing coming first in the list factors to be considered by trustees. This would not alter the content of the list (which is presented as non-hierarchical anyway) but would suggest a different emphasis. This would be in line with guidance from the Office of the Scottish Charity Regulator (OSCR), in which "operating in a manner consistent with the charity's purpose" is presented first on a list of factors to be considered by trustees.

3.3 Ensuring Trustees have appropriate skills and knowledge
3.3.1 Trustees can delegate day-to-day decision making to an investment manager and have a duty to seek out appropriate advice on financial matters. It would perhaps be helpful to make it clearer in the guidance that this is not solely limited to investment advice, and that in many cases it would be prudent to engage in a prior process of strategic and financial planning that helps to place a charity's investment aims and requirements in a wider context. This is particularly key where trustees are making complex decisions about how best to align the mission of their organisation with their investment goals and the expectations of their donors, supporters and other stakeholders. In such cases, investment advisers alone are unlikely to have the required skills or knowledge to take into account all of the relevant factors, so trustees may need to engage other specialist strategic advisers. It is also important that trustees themselves are equipped with the knowledge and skills to understand and interpret any advice they are receiving. The revised guidance could do more to emphasise this need for training, and could perhaps even signpost resources which trustees could consult for impartial advice and support.

3.4 Trustees having confidence that they took necessary steps
3.4.1 It is very positive that the guidance makes clear that trustees "can take a responsible investment approach even if there is no apparent direct conflict with your charity's charitable purposes, if you can show this is in the best interests of your charity", as these are precisely the cases where there has historically been most uncertainty and where there is the greatest likelihood for growing the market for responsible investment by charities.

3.4.2 There may still be issues, however, in the interpretation of what it means to "show that this is in the best interests of your charity". Decisions taken to adopt a responsible investment approach that are *not* based on direct conflicts with the charity's stated mission are likely to involve considerations of the views of supporters and the wider public, and the likelihood of these resulting in longer-term damage to the organisation's reputation and its relationship with its existing or potential supporters. These may be relatively complex and subjective assessments on issues where there is no clear-cut consensus. Furthermore, there may be an asymmetry between considerations of these kinds of political and reputational risks, where hard measures may be lacking; and potential financial risk, where such measures are more likely to exist. If trustees are to have the confidence to balance these different kinds of risks and make the right decisions about investment strategies for their organisation, it is therefore vital that they have certainty on what constitutes appropriate evidence in these kinds of situations and how it needs to be documented It would be hugely helpful if the proposed guidance was updated to include

further information on this point (perhaps in the form of a worked example of how such a decision process might be handled and documented).

3.5 Market developments and long-term sustainability of investments

3.5.1 An overarching question is whether the revised guidance draws too great a distinction between responsible (or ethical) investment and financial investment. Whilst the guidance is clear that trustees can adopt a responsible investment approach, in the way it is worded and structured there is an implication that the two are mutually exclusive and that there is a clear choice or inherent trade-offs between investing responsibly and getting a financial return. However, it is far from clear that this is the case.

3.5.2 An increasing body of evidence shows that “responsible” investments can in many cases match or even outperform “traditional” investments. Some larger investment funds have already adjusted their approach to reflect that fact that some areas previously considered profitable are less reliant than they were due to changing social, environmental and technological factors and that moving away from these asset classes is actually the more financially prudent thing to do in the medium- and longer term. The long-term financial interest of their charity is a core consideration for trustees when making an investment. There may also be wider risks to consider in situations where an investment is currently seen as prudent from a financial standpoint but comes with high reputational risks that can subsequently translate into financial risk; for example for fundraising charities who may lose large parts of their donor base if they disagree with the approach taken.

3.5.3 When it comes to the climate crisis, for instance, there is growing consensus across the public, private and third sectors that from both an ethical and commercial perspective concerted action is needed. Political parties are responding with a focus on net-zero policies in the UK and across the globe, which will have wide-ranging regulatory implications that will impact all sectors. Businesses are recognising shifts in consumer attitudes and growing consciousness of ‘shared values’ to maintain their mandate to operate. Large public institutions are setting their eyes on the topic as well. The Bank of England, for example, set out an ”indicative path towards mandatory climate-related disclosures across the UK economy, aligned with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD)” and published its own climate-related financial disclosure for the first time in June 2020. This coincides with developments in the social sector. Increasing numbers of charities are taking the decision to divest from certain asset classes, which can also be a result of public and stakeholder pressure. The Association of Charitable Foundations (ACF) is hosting the Funder Commitment on Climate Change which includes six commitments that charitable foundations and other funders will take on climate change.

3.5.4 Other legislation has evolved to reflect these changes. The 2006 Companies Act (which also applies to many charitable companies) introduced a duty on directors to take into regard the impact of the company’s operations on the community and the environment when promoting the success of the company for the benefit of its members as a whole. There are also currently

changes to the SORP being discussed which might require charities to report on their investment strategy.

3.5.5 This makes it clear that as we look over a longer-term investment horizon and consider cross-cutting issues such as the climate, the lines between “responsible” or “ESG” investment approaches and basic investment prudence become ever more blurred. Many of the criteria that this guidance suggests are relevant to taking a “responsible investment approach” – such as consideration of shifting public opinion on issues like the climate crisis – are arguably criteria that should simply be applied to *all* investment decisions.

3.6 Proportionality

3.6.1 There is a potential question as to whether the guidance could further clarify a degree of proportionality with regard to the investment duties and responsibilities of trustees. The charity sector as a whole holds significant amounts of assets, but the vast majority of charities are small with incomes below £100,000. Some charities have the capacity to track their investments in detail (either by having their own investment managers working for them or having a close relationship with a dedicated investment manager), and some may even be in a position to act as ‘activist investors’ by using shareholdings to ask questions at AGMs and campaign publicly to influence industry practices. A charity with large assets may, for example, be in a position to investigate all of its financial relationships to ensure they meet its intended investment ambitions, and even to put pressure on providers if they fail to do so. But the vast majority of charities will not have that capacity. Even if they do have the resources to pay for external advice, they are unlikely to be able to afford advice or products highly tailored to their specific needs so they will be beholden to whatever the current standard market offering may be. This may mean, for instance, that there is a risk of a gap between a charity’s investment aims or the expectations of its supporters and its actual investment holdings. It is important that trustees feel reassured that in such instances they will not be held unreasonably accountable for factors beyond their control; and they have confidence that as long as they have acted in the best interests of their organisation at all times and clearly documented all decisions they will have discharged their duties and responsibilities appropriately.

4. Question 2

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

See reply to question 3 below.

5. Question 3

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

5.1 The term “responsible” is not perfect – for one thing it carries the implication that those organisations choosing not to follow this route are investing “irresponsibly”, which presumably is not the intention – however it is probably the best available option reflecting existing market usage and the intended meaning for the purposes of this revised guidance. As highlighted in answer to question 1, there is a fundamental question as to whether there is a genuinely meaningful distinction between responsible investment (as defined) and other types of investment, or whether in fact all investment should be responsible by default given trustees' obligations to make decisions in the long-term interest of their charities.

5.2 There is a wide range of terminology already out there that is used to describe how charities' wider activities are aligned with their own mission and values (e.g. Programme-Related Investment, Mission Connected Investment). Then there is a different, and similarly wide, set of terminology used in the investment space - with ESG being probably the most established. The language in the revised guidance needs as far as possible to be aligned with what practitioners, charity staff and trustees use and with which they might be familiar. It also needs to be “translatable” to the day-to-day activities of investment managers. The use of the term “responsible investing incorporating ESG factors” might be one possibility that would better reflect current usage.

5.3 “Responsible investing” as a term does compare favourably with the previous use of “ethical investing”. Whilst “responsible” is also subjective to some degree, it carries a less obvious implication of value judgement being made. Any framing in terms of value judgements is problematic as it is more likely to lead to instances in which trustees (either accidentally or deliberately) blur the lines between their individual views and what is in the best interest of the charity. Whilst the guidance does make it clear that trustees are bound by fiduciary duties and must not allow their personal motives or prejudices to affect the investment decisions they take (as listed under 3.1 in the guidance), the importance of this core principle could perhaps be further emphasised.

6. 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?

6.1 Fairly confident. Most of the required information is present in the guidance to guide trustees in making these decisions. The language and ordering could be changed in some places, as suggested, in order to shift emphasis from responsible investing being something you have to opt in to, to something you need to opt out of. There are also a number of points that might benefit from further clarification or worked examples as detailed in other answers.

7. 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?

7.1 The guidance is clear that if a "charity has money or investments which are permanent endowments, extra rules apply to your financial investment'". This is a point that might benefit from further clarification as there are some readers who may not, for instance, understand the distinction between a permanent endowment and simply having investments and will therefore be unclear as to whether the extra rules apply to them or not.
The five tests in the additional rules are clearly described in terms of the language used in the guidance. But there might still be practical challenges for trustees when it comes to applying them.

7.2 The second test criteria, for example, allows trustees to choose a responsible investment approach when the "charity might lose supporters or beneficiaries" if a responsible investment approach is not taken. Any risk of lower returns (in both the short and longer term) can be balanced against the risk of losing support or damaging the charity's reputation. In practice, however, it might be very difficult for trustees to assess trade-offs and more guidance might be needed for a situation when trustees are faced with a decision where they have to take account of financial return (which is a more measurable factor) and more contextual and hard-to-capture reputational risks (as outlined in our answer to question 1).

7.3 The assessment of which investments constitute a potential reputational risk can be difficult to make if different stakeholders have differing perceptions – for instance if investing in a particular technological solution or business approach is seen by one group of supporters as positive whilst a different group takes a divergent view. This assessment may also change over time as a result of technological developments, changes in a particular company's activities or shifts in wider public opinion. It is therefore hard to predict which elements of a charity's investment activities will come under scrutiny, which is another reason it is vital that trustees ensure they review investment policies, strategies and procedures regularly.

7.4 The final test in the extra rules allows trustees to choose a responsible investment approach if they "have clear and compelling reasons, supported by evidence, about why [their] charity should follow a responsible investment approach". The question here is what constitutes a clear and compelling reason, and what kind of evidence would be deemed sufficient. It is also important that any requirements for evidence are once again proportionate to the size of a charity and its investments. It would be useful to provide further examples in the guidance to help trustees understand what is expected of them in terms of the information they should collect and record to underpin their reasons for choosing a responsible investing approach.

8. Question 6

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

8.1 There are a few areas where it would be helpful for the guidance to highlight particular points more clearly. Firstly, the importance of ensuring that any decisions about investment approach are set in the context of prior financial planning, which incorporates an assessment of an organisation's assets, income streams and costs over the medium to long-term. Having a holistic financial picture of an organisation and modelling potential developments should be seen as a prerequisite for deciding what a financial strategy should look like and how investments should feature in it. There is a real need, for example, to ensure that money offered up for investment is not going to be needed to manage regular cash flow or other emergency situations.

8.2 The guidance could also highlight the need to review investment policies and procedures regularly (e.g. every three years at a minimum). This will ensure that changes in the external environment can be taken into account, and any necessary changes to investment strategy or approach made. Furthermore, regular review will help to minimise any issues arising from new trustees joining and being unaware of prior investment decisions that may have long-term implications.

It would also be useful for the guidance to signpost sources of information and support, to help trustees ensure that they have the skills and knowledge they need either to make investment decisions or to assess and interpret information and advice provided to them by external investment advisers.