Charity Finance Group: Charity Commission Responsible Investment Guidance Consultation Response

May 2021

About CFG

Charity Finance Group (CFG) is the charity that inspires a financially confident, dynamic and trustworthy charity sector. We do this by championing best practice, nurturing leadership and influencing policy makers. Over 1,400 UK charities turn to us to develop their finance management knowledge and skills. Collectively, these charities manage £22bn of funds – that represents around a third of the entire charity sector's income.

Overview

- Charities are a rich part of society and are increasingly playing their part to enact change which is in the wider public interest. The revision of the guidance on Responsible Investment is an opportunity to empower charities to play a greater role in tackling a crisis impacting the whole of society and to produce guidance which is forward looking and goes beyond what is already standard practice within investment firms and charities which choose to invest. It is CFG's view that the draft guidance doesn't go far enough.
- Language can act as a great barrier and particularly so when it is technical in nature. We would urge the Commission to further simplify language where possible to help aid understanding amongst trustees.
- The Commission retains the view that charities should provide justification for a responsible investment approach. In the context of the transition to Net-Zero by 2030, CFG urges the Commission to change this position and instead actively encourage trustees to consider a sustainable investment approach.[1]
- CFG recommends the Commission make changes to the proposed guidance to actively encourage sustainable investment, not only as a means to ensure charities show leadership and retain public trust and confidence, but to mitigate financial risks.
- Rather than tweak the current guidance, as has been proposed, CFG calls on the Commission to consult on fundamentally revising CC14 and to actively encourage all charities to consider a sustainable investment approach, where there is mission alignment between a charity's investments and their purpose.

Charity Finance Group is responding to this consultation on behalf of its membership.

To contact the Charity Finance Group about this response, please email Richard Sagar, Policy Manager at richard.sagar@cfg.org.uk

[1] As defined in 'G8 Social Impact Investment Taskforce, Asset Allocation Working Group' (2014)

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 updated guidance is an improvement on the previous iteration. The change in section 4.2 to the following point has increased clarity; "*When considering which companies and organisations to invest in, all charities* ***can*** *take into account such factors as impact on climate, employment practices, sustainability, human rights, community impact, executive compensation and board accountability."*

Question 3

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

It is helpful that the Commission has offered its own definition in the Technical Annex as "*Responsible investment is, rather than just focusing on the financial return on an investment, taking into account your charity's purposes and values when making financial investments*."

However, this differs to how it is frequently used within the investment community. For instance, the G8 Social Impact Investment Taskforce, Asset Allocation Working Group definition is to "*Mitigate risky environmental, social and governance practices in order to protect value*." This is a wider definition than the Commission uses, as it includes ESG risks which may affect the value of investments, rather than just those which relate to the purposes and values rated to your charity. From conversations with investment firms, it is our understanding that they would also understand the term to mean something closer to the G8 Social Impact Investment Taskforce definition.

We would also argue that there is further confusion within the guidance, as Section 2.1 defines Responsible Investment as being synonymous with ethical investing, or mission aligned investment, particularly with the examples given in the bullet points of positive/ negative screening and stakeholder activism.

As the Commission defines "Responsible", we would argue that trustees should always seek to be "responsible" with the finances of their charity and so seek for all investment to be responsible in so far as this definition applies. If this is the definition the Commission wishes to adopt, then we recommend that the Commission should focus on helping trustees understand how they can invest responsibly.

CFG recommends the guidance be changed so that all charities should invest responsibly, as a minimum requirement, without the need for additional justification, as proposed in the revised guidance. We would also go further to suggest that the Commission should actively encourage sustainable investment.

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?

CFG is assured that the draft guidance makes responsible investment more permissible as a valid option than the previous iteration. We however have some important caveats to add to this endorsement.

Following conversations with legal firms and charities, we understand that there are still fundamental unresolved questions with the legal guidance. For instance; when is there a 'duty to invest', and to what extent, if ever, it is permissible to not take account of your charitable purposes when investing, and when should one consider an investment to be conflicting with charitable purposes. In addition, from a purely financial perspective, what risk of financial detriment is acceptable for a trustee of a charity. These are just some of the considerations that trustees might consider that the guidance does not currently address.

As others have outlined[2], the "Reasons to invest" section of the guidance continues to implicitly presume that there is a conflict between financial return and responsible/ ethical investment, as it offers two different reasons as to why a charity might seek to invest; financial investment and 'social, programme-related, or mixed motive investment.'

We believe this is a false dichotomy, as when one compares the rate of return between ESG funds and other funds, there is little or no difference. CFG recommends that the Commission should not present these approaches as being in conflict within the guidance.

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?

CFG does not think that giving tests to which responsible investment can take place is helpful. Instead, CFG advocates that sustainable investment should be actively encouraged by the Commission.

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2 https://www.acf.org.uk/downloads/publications/ACF_response_on_CCEW_investment_guidance_13_May_2021.pdf

Question 6

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

CFG understand that this is only the first step in re-writing CC14, however CFG believes there is a huge opportunity to go further that should not be missed. We urge the Commission to use this as an opportunity to fundamentally re-write the guidance to take into account a number of major issues not explicitly addressed, most notably climate change.

It is widely understood by investment firms (and economists more broadly) that climate risks are not merely an environmental consideration, but increasingly a financial one. Morgan Stanley has said that "*Climate change has become an investment consideration impossible to ignore, as related disasters and economic losses grow and regulators increasingly recognize it as a systemic financial risk*."[3] This analysis is not unique and is shared by the Bank of England, which enhanced the Prudential Regulatory Authority's approach to supervising the financial risks from climate change. [4]

Pensions Minister Guy Opperman has said of the risk of climate change in relation to Pension investments "*Climate change is a major systemic financial risk and threat to the long-term sustainability of UK private pensions. With almost £2 trillion in assets under management, all pension schemes are exposed to climate-related risks and I am committed to ensuring trustees do everything they can to limit this risk to their members' future retirement income*"."[5]

CFG argues that the Commission should make a similar commitment within the updated guidance on charity investment, to ensure that trustees are aware of the potential risks from climate change, and actively encourage them to mitigate these risks in their investments. CFG proposed that the Commission should seek to move beyond 'Responsible' investment to 'Sustainable investment' as defined by the G8 Social Impact Investment Taskforce, Asset Allocation Working Group'- to adopt progressive environmental, social and governance practices that may enhance value'.

In addition to the sizeable financial risks from failing to mitigate for climate change within the updated guidance, (which itself is sufficient to warrant changing it) CFG believe that societal expectation for charities should see the Commission urge charities to invest sustainably.

Charities are a rich part of society and are increasingly playing their part to enact change which is in the wider public interest. This is an opportunity to empower charities to play a greater role in tackling a crisis impacting the whole of society and to move away from investment in companies who extract rather than add value and be safe in the knowledge that, not only is this an appropriate use of charity funds, but that it is actively considered to be the right thing for all charities to do in all but exceptional circumstances.

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[3] https://www.morganstanley.com/ideas/climate-change-investing-risks-threats-opportunities
[4] https://www.bankofengland.co.uk/climate-change
[5] https://www.gov.uk/government/consultations/taking-action-on-climate-risk-improving-governance-and-reporting-by-occupational-pension-schemes-response-and-consultation-on-regulations/taking-action-on-climate-risk-improving-governance-and-reporting-by-occupational-pension-schemes