

POSITIVE IMPACT INVESTMENT: TOO GOOD TO BE TRUE?

ECCR's 2010 open debate took place on Thursday 18 November at Methodist Church House, London. Chaired by Lord Harries of Pentregarth (former Bishop of Oxford), the panel featured speakers James Bevan of CCLA Investment Management, Ryan Brightwell of Co-operative Financial Services, Clare Brook of WHEB Asset Management, and Adam Ognall of UKSIF (UK Sustainable Investment and Finance).

The debate identified grounds for optimism that a positive impact approach to investing can speed progress to a fairer and more environmentally sustainable economic system, and churches can help lead the way. However major challenges remain.

James Bevan, CCLA: 'Achieving the shift from talk to walk'

For James Bevan, unbridled capitalism is deeply flawed and needs to be tamed and harnessed. If positive impact investment is to reach its potential, governments must ensure the internalisation of social and environmental 'externalities' with international rules and regulations, and public engagement is needed to drive outcomes.

The present crisis demands both immediate action and a long-term view. Sustainable long-term investing means planning for the present and the future and investing both in mainstream and in specialist ESG (environmental, social and governance) areas. But it is not easy in practice, and there is a lack of clarity and consensus on objectives and outcomes. A notable risk is that while we can reasonably expect some level of failure in the field of new and high profile environmental technologies, failure to achieve desired outcomes - including financial success - may lead to disengagement.

Yet fund managers can square fiduciary responsibilities with positive impact investing if the points of focus and outcome are 'and' rather than 'or'. Particularly if impact investing addresses uncoded externalities and risks that may adversely affect future returns, it is more likely to be associated with reliable financial returns and attractive payoffs.

The shift needed requires expansion in the level, availability and accessibility of intellectual capital and knowledge, a tip point at which investors commit capital and real (rather than intellectual or emotional) focus, positive experience leading to a self-reinforcing pick-up in interest, growth in supply of opportunities, regulatory reform, and changes to the net costs of investing.

CCLA is the largest manager of charitable funds in the UK and owned by its clients. Following an extensive survey of its charity clients, including faith organisations, it has repositioned its existing responsible fund and launched an ethical investment fund to give charities a more powerful way to address concerns about human rights, climate change and contentious activities. This change also includes greater engagement with companies and investing a higher proportion of funds for positive social and environmental impact. CCLA is confident that these changes will result in more sustainable long-term financial returns.

Clare Brook, WHEB: 'Thematic investment – more ethical than ethical'

Clare Brook began with the growth of the UK ethical investment industry to £9.5 bn in 2009. With this growth, ethical investment has also become more mainstream, to the point where some ethical funds are almost indistinguishable from standard unscreened funds in terms of portfolio holdings in major multinational companies.

In developing a more 'cutting edge' approach, WHEB has launched its Sustainability Fund, which focuses on three key themes of concern to ethical investors that encompass major challenges facing humanity: climate change and rising energy costs; the limited availability of clean water in a

highly populated world where per capita water consumption is rising; and the ageing population in Western societies, linked to declining family support networks and increasing longevity and quality of life expectations.

Companies addressing these themes offer exceptional growth opportunities, and a focus on the three themes means that the WHEB fund remains adequately diversified. The ageing population focus in particular enables the fund to take defensive positions and protect capital values. By contrast, funds that invest in alternative energy only can perform well as markets rise but will suffer in falling markets.

On climate change, the fund invests not just in renewable energy but also in clean technology such as smart grids, fuel cells and rail transport. Opportunities around water include water efficiency, infrastructure and utilities. For the ageing population theme WHEB focuses on companies that provide medical devices, care and services for the aged, implants and orthopaedics.

This has resulted in a balanced portfolio of holdings in a very distinct group of companies that were formerly accessible only through venture capital investors. They are almost entirely absent from the 'top 10' standard ethical portfolio. All enjoy very satisfactory growth in shareholder value. The WHEB fund, which is very actively managed, has performed well compared with other funds and indexes since its launch in mid-2009, especially as against alternative energy investments.

Ryan Brightwell, CFS: 'Investing for impact across banking, insurance, equities and bonds'

Ryan Brightwell provided a business overview of Co-operative Financial Services, including its democratic ownership structure and customer-led ethical policies. During the recent crisis the bank has seen considerable growth in numbers of personal account customers - which it attributes largely to being well trusted - and in profits.

Co-operative Investments offers three funds that aim to make a positive contribution to environment, human welfare and sustainability, focused on three themes: demographics, sustainable infrastructure, and power/climate change.

The Co-operative Bank launched its ethical policy in 1992 and this determines who the bank will and will not finance. The bank has reviewed the policy five times to date, most recently in 2009 when 80,000 customers participated in the process. There is a strong customer mandate to support banking for areas such as fair trade, micro-finance and renewable energy.

A quarter of the bank's lending is directed to organisations that it considers make a positive contribution to society, such as charities, public sector bodies and co-operatives. It has committed a further £200m to UK renewables projects this year, including the Torrs micro-hydro project in Derbyshire and a community-owned wind turbine on Tiree, Inner Hebrides.

CFS has recently committed £14.5m of shareholder capital to social private equity funds such as the Bridges Venture Fund, supporting UK start-ups in deprived areas. It is keen to support 'green bonds' such as World Bank Green Bonds and proposed Green Investment Bank bonds, as well as Green ISAs as proposed by the Green Investment Bank commission.

Adam Ognall, UKSIF: 'Impact investing: a leadership opportunity for faith communities'

Impact investing offers faith-based investors a holistic approach, enabling them to blend 'doing well' with 'doing good', said Adam Ognall. The idea has been around for a number of years, as exemplified by such initiatives as the Grameen Bank and the UK Social Investment Task Force. We are now well past the pioneering stage.

An UKSIF definition of impact investment is 'an investment whose primary motive is social and/or environmental'. This does not mean the investment should not deliver a financial return, but it is differentiated by this primary societal motive rather than financial objectives.

UKSIF research shows that more than half of investors want to 'make a difference' as well as

making money; and 38% of those aged 55-plus take into account green and ethical issues – a higher rate than for 18-24-year-olds. Priority issues that people report wanting to influence through their investments are renewable energy, recycling and waste reduction, child labour, and support for local communities.

UKSIF has just completed co-ordination of a third successful National Ethical Investment Week, working with a range of other bodies, including ECCR, during which it has promoted awareness of, and involvement in, ethical and impact investing.

The financial crisis – ‘a fairly complete train wreck of a predominant theory of economics and finance’ in Lord Turner’s words - has led to a greater appreciation of risk. Faith communities now have an opportunity to show leadership in impact investing as they have in fair trade – both by helping grow demand and by influencing public policy.

Questions and discussion

Lord Harries invited questions and observations from the audience, and responses from the panel.

Do we need a new understanding of the concept ‘fiduciary responsibility’ and risk?

Clare Brook (CB): Risk certainly needs to be understood more broadly. Nobody apparently foresaw the BP Deepwater Horizon disaster. Holdings in BP would not have been considered risky but turned out to be high risk as BP share values fell.

James Bevan (JB): A key fiduciary challenge is to address issues of inter-generational fairness, and this requires innovative forms of investment.

Are current church ethical investment policies still sufficient, and if not, how should such policies develop?

Adam Ognall (AO): A total change of direction is not required. But positive impact investing transcends traditional negative screening, so approaches do need to evolve.

Ryan Brightwell (RB): People want to know where their money is being invested as well as what is being avoided, and potentially the appeal is to a widening audience.

JB: The churches are moving beyond avoidance towards engagement, for example on issues of corporate governance, remuneration and supply chain conditions. Recent engagements by church investors have included dialogue with supermarkets about the UK dairy industry, efforts to influence mining company Vedanta, and work on child labour in retailers’ supply chains. This has helped bring about change in company policy and practice.

CB: Negative screening as a stand-alone investment strategy has had its day.

Taking as an example the work of Shared Interest, which facilitates investment in fair trade, is there a conflict between maximising financial return and addressing ethical concerns?

CB: Church investors could adopt a ‘hub and spoke’ strategy. They could hold at the hub of their investments a lightly screened fund with heavy engagement with larger major-footprint companies; as their main ‘spokes’ invest in thematic positive funds (such as leading solutions-oriented equities); and also have a few ultra-high-impact investments in community funds.

How should we respond to concerns that more developed countries are still imposing an unwanted form of economic development on communities such as Indigenous Peoples in the global South, who for example don’t want supermarkets?

AO: Through the work of ECCR and others ethical investors are becoming more aware of, and responsive to, such concerns and risks, and this is gradually influencing companies.

The churches are seeking to align their mission responsibility for justice and peace, and their prophetic voice, with action to change the way business works from within; church support for a

'Robin Hood' Tax on foreign currency transactions is an example of this engagement

RB: There are good arguments in favour of a small (0.005%) currency transaction tax. Implementation is feasible, and it would go far to address government budget deficits and global challenges such as climate change and poverty.

Work by the UN Principles for Responsible Investment initiative¹ and by law firm Freshfields on fiduciary duty² supports the importance of a positive impact stance and challenges more conventional investing wisdom

RB: Integration of ESG (environmental, social and governance) issues in investing has grown significantly, and fund managers who ignore such issues are in breach of their fiduciary responsibility.

CB: Companies and fund managers who neglect corporate governance and ESG issues are irresponsible, will be exposed to risk and may suffer major reputational damage.

AO: Money managers need to be challenged more on ESG issues – they are challenged all too little. There is currently a disconnect between their short-term profit horizons and long-term concerns. Quarterly fund performance should not be highly rewarded.

JB: We are on the edge of another financial crisis and urgently need a new set of global rules - in particular, on disclosure of the quality data we need on social and environmental impacts and risks incurred by business. The G20 governments have not met this challenge

How should we address the growing influence of Chinese companies worldwide?

JB: There are major human rights issues in connection with Chinese companies, but the global system is driven by economics, and such issues tend to get ignored.

RB: China is not unique. Human rights and labour standards concerns arise worldwide.

Has socially responsible investment had real impact?

JB: Its impact has been disappointing to date.

AO: As cheerleader for the SRI industry, UKSIF would claim that it has had impact, although it is not yet mainstream. The sector has grown fourfold in ten years and can grow further by adopting a flexible rather than 'all-or-nothing' stance. Yet it still represents only 2 per cent of the investment market. A major job still needs to be done.

CB: ESG-based approaches are now far more widely accepted as valid than they once were, especially since the BP disaster. Today more than three-quarters of FTSE-listed companies publish ESG reports, although some of these are largely 'greenwash'.

Do hedge funds and futures have a valid function for ethical investors?

JB: Hedge funds have a place, but their fees and charges are 'legal theft'.

CB: Hedge funds can be destructive and immoral, as when they buy shares in innovative problem-solving companies in the clean-tech sector purely in the hope that such companies will crash. As such, hedge funds should be banned [a sentiment well supported by a show of hands].

AO: Hedge funds and other complex instruments helped precipitate the economic crisis. They lack transparency and in most cases a socially useful role.

www.eccr.org.uk

¹ www.unpri.org

² See *Fiduciary Responsibility: Legal and practical aspects of integrating environmental, social and governance issues into institutional investment*, UN Environment Programme Finance Initiative, 2009, www.unepfi.org