UK Sustainable Investment and Finance Association

5 September 2016

Clerk to the Select Committee on Charities
Committee Office
House of Lords
London SW1A 0PW

Dear Mr Hussey,

House of Lords Charities Committee Inquiry

1. Thank you for the opportunity to contribute to the Select Committee on Charities' inquiry into the sustainability of the charity sector and the challenges of charity governance. We appreciate the chance to put forward our views which focus on issues surrounding charity investment. Our response is therefore directed towards questions 8 and 9 of the call for evidence document. Feedback from our members has been that these questions are probably unhelpful, and that they should be broadened, giving more focus to the potential for charities to invest in-line with their objectives.

2. UKSIF is the membership network for sustainable and responsible financial services in the UK. We promote and support sustainable and responsible investment (SRI) and other forms of finance that advance sustainable economic development, enhance quality of life and safeguard the environment. We also seek to ensure that individual and institutional investors can reflect their values in their investments. UKSIF was created in 1991 to bring together the different strands of sustainable and responsible finance nationally and to act as a focus and a voice for the industry. We have around 240 members and affiliates including financial advisers, institutional and retail fund managers, pension funds (including local government schemes), banks, research providers, consultants and NGOs.[1]

3. We would define social investment as an investment strategy which seeks both a social and a financial return. It is therefore important to understand that there are two key aspects in relation to social investment and charities. First the potential for social investment and social impact bonds as tools by which charities can further their own mission, where the majority of this response is directed. These have the potential to be useful tools, although this is only one route a charity can take to further its social mission or invest in-line with its objectives. Second, social investment as a means by which charities can raise capital to ensure their own sustainability and that of the sector more generally, which is addressed in paragraph 12 and 13.

What is the potential of social investment and social impact bonds?

4. Despite a clear and increasing appetite for social investment, some charities have tended to be cautious of this new area of investment. For many charities, due to the obvious correlation between their mission and a resulting "measurable social return", social

[1] For more info about UKSIF, please visit www.uksif.org.

investment is a good option. Nonetheless, social investment has yet to reach its potential for a variety of reasons. Some investments may be illiquid or volatile, in some cases investors are concerned about value destruction. We have heard of some charities being reluctant to invest their capital at all, let alone via the social investment route and it is not a given that charity boards will understand what SIBs are. This is still a nascent market and objective assessment of factors such as diversification, past returns and illiquidity may be harder due to a shorter track record (although this will be overcome as more evidence becomes available). Currently these types of investments may be considered more risky than traditional investment because of this. A lack of understanding is therefore a crucial barrier to uptake of social investment.

5. In particular better understanding is needed around the degree to which investors can achieve both a financial and a social return both legally and financially.[2] Charity trustees tend to use fund managers or financial advisers. We have heard of a 'distribution challenge' where these intermediaries do not include social investment in their list of permitted investments and so the investments are not made. In this situation a lack of understanding amongst the intermediaries themselves is the barrier.

6. Feedback has been that the faith market is particularly well placed to correlate investment decisions with the mission of the charity. Some investors are uncertain whether they are in breach of their fiduciary duty if they do not adhere to their stated objective. Since it is easier to correlate investments with mission, the potential for social investment is higher in the faith market.

7. Every year UKSIF commissions polling for Good Money Week in relation to savers' views on their investments. This year it revealed that 54% of people with savings want to make a "positive difference" as well as a return. Standard Life commissioned polling revealed a positive correlation between positive values and youth with 58% of millennials wanting to invest in companies that achieve positive social outcomes, and 51% wanting to invest in ways that minimise environmental damage. More millennials have investments or savings than at any other time in recent memory, mainly thanks to automatic enrolment. This is proof not only of the existence of a social investor, but a far larger pool of social investors than had been predicted previously. Prudent charities should start to consider these views and the extent to which they are prevalent amongst their members and supporters, as well as their own impact on society and the environment, in order to stay competitive.

What are the barriers to fulfilling their potential?

8. Quantitative and qualitative data is vital to enable investors to assess businesses' ability to create value over time. It would also be extremely helpful in enabling charity investors, or those wishing to meet a stated mission, to understand how an investment could help them achieve their social objective. Over the past few years there has been an increased focus on transparency and corporate reporting. These developments are welcome and have represented an increased recognition of the importance of sustainability factors in business

[2] UKSIF member feedback.

performance. In our submission to the BIS consultation on non-financial reporting[3] we called for the government to ensure that 'non-financial information'[4] was included in the strategic report because it provides detailed information to stakeholders on a business' ability to create value over time. We would go further than this and call for fully integrated reporting on sustainability factors. Far from being a burden on business, integrating financially material sustainability concerns into business models would ease year-end reporting. It would also enable investors of all types to fully assess the universe of impactful investments available to them, further driving the benefits to society and the environment. This would vastly expand the supply of impactful investments as well as remove any concerns over scalability. It would also force all enterprises to seriously consider their impact on society and the environment, making this a mainstream concern, rather than relying on the niche universe of investible assets. A recent Eurosif and ACCA study showed that 96% of investors agreed or strongly agreed that quantitative KPIs are essential to assess corporate sustainability performance, while 76% agreed or strongly agreed that qualitative policy statements are essential.[5] Improving this data would support social investors of all types, but be a particular boost to charity investors wishing to achieve their mission without necessarily going down the social investment route.

9. Legal clarity is vital, not just in social investment but in charity investment more generally. The leading case for 'ethical' investment remains *Harries* and there is a lack of appetite from the Charity Commission and OSCR to issue guidance on such areas despite the fact this case took place 25 years ago. Regulatory steer tends to be prioritised for areas where there are problems, or those which relate to risk. The recent legal opinion by Christopher McCall QC has resulted in further uncertainty for charity trustees in relation to their fiduciary duties and responsibilities. For Ownership Day 2016 UKSIF published a report on the fiduciary duties of pension and charity trustees which goes into more detail on the opinion and outlines our views.[6] McCall drew a distinction between what he terms 'latent' and 'patent' conflicts for trustees. Patent conflicts are where an investment conflicts with the charity's objective and so the charity must divest regardless of financial consequence. This may be the case where a cancer charity holds stocks in a tobacco company. Latent conflicts are where the conflict is less obvious and the trustees must weigh the risks to the charity's work against the risk of divestment. Here concerns on how investments affect the community and the environment will require more thought. McCall goes on to say:

10. *"It is for charity trustees to determine whether there is a link between the specific purposes of a charity and the dangers posed by the investments concerned, such as in the case of carbon intensive assets, in the light of the prevailing evidence. Though the conflict may not always be clear cut I think it at least arguable that investment in carbon intensive assets could be said to be irreconcilable with the intent behind charities with:*

    a. *General or specific environmental purposes;*

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[3] Available at http://uksif.org/wp-content/uploads/2016/04/UKSIF-Response-to-BIS-NFR-consultation-FINAL.pdf
[4] Since this information is financially material this term is a misnomer and therefore unhelpful.
[5] Eurosif and ACCA, *What do investors expect from non-financial reporting?*, available at http://www.accaglobal.com/content/dam/acca/global/PDF-technical/sustainability-reporting/tech-tp-wdir.pdf
[6] UKSIF, *Understanding and Applying Fiduciary Duty,* available at http://ownershipday.co.uk/wp-content/uploads/2016/03/Fid-duty-report-FINAL3.pdf

b. *General health purposes;*
c. *General poverty purposes;*
d. *Other purposes relating to matters where the properties of carbon intensive assets and the consequences of dangerous climate change are of particular concern."*

11. These conflicts may be material to charity social investors. This lack of clarity over the law may therefore present a barrier to increased social investment by charities and we have called on the Charity Commission to update its CC14 guidance to address the McCall opinion as a matter of urgency. It is worth noting the most recent update to the guidance, published on August 1st, on social investment by charities did not address this.

Raising capital through social investment

12. In the wider context of the sustainability of the charity sector, some charities may wish to raise capital from social investors. In our response to the FCA's call for input on the regulatory barriers to social investment we highlighted some concerns with the ability of charities to raise money from the general public for social investment.[7] The motivations for securing income from the general public are varied and include a more diversified investor-base, raising awareness for the work of the charity, and forging deeper connections with the communities in which they operate. There are clear financial benefits to charities from raising money from a wider range of sources and for increasing the sustainability of the sector more generally. The Government has been supportive and introduced various useful initiatives to encourage more investment from the public, but in understanding what more can be done it may be useful to look at international models, as outlined by Big Society Capital.[8]

13. One potential barrier to growing the social investment market is the introduction of rigid definitions. Some charities may begin to look towards social enterprise models to achieve their objectives via business solutions while also ensuring their own financial sustainability. In our submission to the Cabinet Office's mission-led business review, and as we have alluded to already, we urged caution against stringent definitions of social enterprises. The Minister's statement that 'every business could, if it wished, be a mission-led business' was welcome and we argued that the core principle of making a profit and having a social impact should not be reserved for small or new businesses. Many UKSIF members invest in businesses – large and small – which aim to tackle many of the social issues faced throughout the country and we note that the Government has been extremely helpful in supporting the development of the UK's social investment market. Generally, however these members are better positioned to invest in large companies or those which are scalable. Too rigid-a-definition of what a social enterprise should be and what social investment involves is a potential barrier to social investment and the Government should understand this before any changes are made following its review.

What should the role of Government be with the sector?

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[7] Available at http://uksif.org/wp-content/uploads/2016/03/UKSIF-response-to-FCA-regulatory-barriers-to-social-investment.pdf

[8] Big Society Capital, Social Investment Insights Series, March 2016 available here: http://www.bigsocietycapital.com/sites/default/files/attachments/Social%20Investment%20Insights%20-%20Retail%20social%20investment%20across%20the%20world_2.pdf

14. The government can play a role in further supporting social investment by and into charities in the UK in the ways we have already described. To sum up:

    a. More joined up thinking is required across government on ways in which social investment can be boosted. This is unlikely to be made easier with the transfer of the Office for Civil Society from the Cabinet Office to DCMS.
    b. The Department of Business, Enterprise and Industrial Strategy should support an increase the quantity of businesses reporting on sustainability issues. This will help increase the universe of investible assets for social investors and help charity investors determine which investments can further their stated mission (and which run contrary to it).
    c. The FCA must ensure regulatory barriers affecting charities' and social enterprises' ability to raise capital e.g. from the general public are addressed.
    d. The Cabinet Office must ensure that any actions it takes including a potential definition for social enterprises is not so stringent that it restricts the universe of investible assets for social and charity investors.
    e. The Charity Commission should issue guidance following the McCall opinion to ensure charity trustees are have clarity over their legal duties and responsibilities.
    f. We have had feedback from members that the Charity Commission should be given more powers to ensure standards are being met particularly given the negative press surrounding some high profile charities over recent years. Some have called for the Commission to play a role in regulating charity portfolios.
    g. Supporting new forms of investment such as crowdfunding from the general public to place the sector on a more sustainable footing.

15. I trust the above information is clear, but if you require clarification on any of the points raised please do not hesitate to contact me.

Yours sincerely,

F. Moffatt

Fergus Moffatt
Head of Public Policy
UK Sustainable Investment and Finance Association (UKSIF)