Lankelly Chase

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Monday, 24 May 2021

By email: GandPSurveys@charitycommission.gov.uk

Re: Charity responsible investment guidance - Lankelly Chase submission

Introduction

Lankelly Chase is a grant-making charity with an endowment worth over £150 million. We support the creation of systems of justice, healing and liberation, to enable people who are subject to marginalisation in the UK to live with dignity and opportunity in supportive communities.

We believe that investment practices currently help to perpetuate systems of injustice and oppression, and that investors must act to positively transform these systems. In our submission to the Charity Commission's 'listening exercise' on responsible investment, we described how our own approach to investing is evolving to better serve our values, purpose, and the needs of our time.[1]

We suggested that charitable purposes and the public benefit require responsible charity investors to pursue positive, real-world outcomes, rather than narrower measures of financial materiality and return maximisation. We argued that genuinely responsible approaches to investing should be the norm for charities, rather than an option. And we called for the Charity Commission to drive greater ambition and openness around charity investments, in line with changing public expectations and the interconnected crises of our time.

Summary

We have three key reflections on the draft guidance now under consultation:

1) We welcome the shift away from "maximising financial returns" as the de facto goal of investment, but the guidance should go further to incorporate 'System Value'.
2) The guidance confuses adherence with objects and standard investment criteria with a genuinely responsible and sustainable approach to investment.
3) The laissez-faire approach evident in the draft guidance is out of step with sectoral and societal attitudes, as well as developments across the wider investment system as it responds to mounting social and ecological crises.

We elaborate on these points below.

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[1] https://lankellychase.org.uk/wp-content/uploads/2020/06/Lankelly-Chase-submission-to-Charity-Commission.pdf

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Key points

1) **We support the shift away from "maximising financial returns" as the de facto goal of investment and call for the inclusion of 'System Value'.**

The axiom that charities should maximise financial returns contributes to a reductionist, short-term mindset which is at odds with charitable purposes, the public benefit and, ultimately, undermines the sustainability of financial returns themselves. It also has no grounding in fiduciary duty, a point clarified by the Law Commission and accepted by the UK Government in 2014.[2]

We therefore welcome the replacement of this language in the guidance, and its legal underpinning, with "making a positive financial return". In addition, this definition of the purpose of investing should be expanded to include "while making a positive contribution to System Value".

It is increasingly recognised that the philosophy of 'Shareholder Value Maximisation' ('SVM') has led investors and corporates to pursue a model of unsustainable value extraction rather than value creation.[3] The consequences of this are wide-ranging and profound. They include constraints on innovation and the capacity of governments, as well as the health and wealth of people and our natural environment - all of which companies and investors rely upon in order to productively deploy investment capital over the long-term.

In contrast to this form of 'Monocapitalism' - which seeks to grow financial capital at the expense of other capitals, mostly to benefit the few - Bill Baue of r3.0 outlines how and why we must collectively progress to 'Multicapitalism' in order to generate overall System Value.[4] System Value emerges through dynamic balancing of all vital capitals, including natural, human, social, intellectual, constructed and financial, in order to maintain their carrying capacities in line with social and ecological thresholds (including planetary boundaries).

Many charity investors now recognise that focusing solely on financial returns, let alone maximising them, is incompatible with their objects and the public benefit. A recent report from the Charities Responsible Investment Network calls on the Charity Commission to anchor investment powers in the "safe and just operating space for humanity".[5] Visualised in Kate Raworth's Doughnut Economics, inhabiting this space will require investment practices to explicitly respect and sustain the social foundations and ecological thresholds.[6]

The departure from "maximising financial returns" in the draft guidance is necessary, then. However, it is not sufficient to ensure that investment practices align with charitable objects and the public benefit. Positive financial returns must respect, and indeed ultimately depend upon, the integrity of the social foundations and ecological thresholds. Attending to the interdependencies between all capitals supports overall System Value, which should be reflected in how the Commission defines the purpose of investment.

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[2] UNPRI (2016): Fiduciary Duty in the 21st Century - UK Roadmap, p.6.

[3] For example, Mazzucato, M. (2018): The value of everything : making and taking in the global economy.

[4] Baue, B. (2020): From Monocapitalism to Multicapitalism: 21st Century System Value Creation. r3.0.

[5] Charities Responsible Investment Network (2021): Growth Narratives - an inquiry and provocation by charitable investors.

[6] Raworth, K. (2017): Doughnut Economics

We strongly encourage the Commission to review r3.0's White Paper, '*From Monocapitalism to Multicapitalism: 21st Century System Value Creation*', to better understand these dynamics and the goal of System Value, as developed by r3.0, Future-Fit Foundation and others.

2) Adherence with objects and standard investment criteria does not amount to a responsible approach.

The way that responsible investment is characterised in the draft guidance is confused and behind the curve of current practice and societal expectations.

The draft guidance defines responsible investment as taking into account charities' objects or interests in addition to financial returns. We have to question whether a charity that adopts narrow exclusions linked to their objects (such as a health charity excluding tobacco companies, to use an example from the guidance), while ignoring the relationship between their investments and climate change, can really be considered responsible in the light of overwhelming evidence to the contrary.

We would argue not: responsible investment must address and positively affect the real-world challenges of our time. To do so, it must recognise their interconnectedness, rather than seek to artificially reduce them to discrete problems. In the case of the health charity, for example, inequality, systemic racism and climate change are at least as consequential for health outcomes as smoking tobacco.

ESG is simply an extension of standard investment criteria which assesses materiality through the lens of financial risk/return.[7] Indeed, it is striking that environmental and social challenges primarily appear in the guidance as sources of financial or reputational 'ESG' risk for charities. It is surely of much greater concern that investing risks compounding real world harms and thereby acts against public benefit and most charitable objects.

What is missing from the treatment of responsible investment in the guidance, to draw again upon the work of r3.0, is a grounding in our real-world context of science-based and ethical norms.[8] Charity investors recognise this and have proposed that social and ecological thresholds be placed at the heart of updated guidance.[9]

This should be reflected in updated guidance along the lines of, "Responsible investment is, rather than just focusing on the financial return on an investment, *operating within the carrying capacities of vital capitals in order to respect social and ecological thresholds, consistent with* your charity's purposes and values when making financial investments" (additions in italics).

3) Laissez-faire guidance sets the charity sector up to be a laggard on responsible investment, when it should be leading.

[7] Loorbach, D., D. Schoenmaker and W. Schramade (2020): Finance in Transition: Principles for a positive finance future.
[8] Baue, B., Thurm, R. (2020): Blueprint 6. Sustainable Finance - Systemic Transformation to a Regenerative & Distributive Economy. r3.0
[9] Charities Responsible Investment Network (2021): Growth Narratives.

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At its 2019 conference, 'Funding on a Finite Planet', the Chief Executive of the Association of Charitable Foundations ('ACF') said that "the changing climate is going to be one of the lenses through which we all have to view our work" and asked:

> *Are we ignoring the 68 billion elephants in the room – our £68 billion pounds worth of endowments? A significant portion of which are invested in a financial system that is harming our environment and exacerbating inequality. Have we really thought about what it means to fund on a finite planet?*[10]

Charities are increasingly thinking and acting on this point.[11] However, as a response to the ACF's question, the laissez-faire nature of the draft guidance falls short.

The Regulatory Impact Assessment for the guidance states that "The Commission is explicitly not introducing any rule or expectation that investor charities should take a responsible investment approach, beyond what may be required by the terms of their governing document."[12]

Even leaving aside the more credible definition of responsible investment outlined above, we would suggest that adherence to objects and standard investment criteria should rightly be considered requirements for all charities, not options.

Adherence to charitable purposes follows implicitly from the "overriding need" for trustees to "deploy their resources in pursuit of their objects", set out in the Commission's 'legal underpinning' to the guidance, as well directors' duties codified in Section 172 of the Companies Act. Just as capital should be allocated to grantees in accordance with charitable purposes and public benefit, so too should it be to investments (which, after all, are typically 20x the size of annual grant allocations).

The other optional aspect of responsible investing, according to the draft guidance, is attention to ESG factors which "can affect the value of a company's shares positively or negatively depending on how the risk areas are managed." To describe this as optional runs contrary to modern investment practice and fiduciary duty. Summarising legal and regulatory developments, including the 2014 findings of the Law Commission, the United Nations Principles for Responsible Investment states that:

> *Fiduciary duty requires investors to consider long-term value drivers in investment processes. ESG factors are a core part of such an assessment [...]*
>
> *The consideration of ESG issues is part of the analytical framework that a prudent investor requires to understand the financial prospects and operational performance of investee companies and the risk and reward profiles of their portfolios.*[13]

Common Wealth think-tank notes that the United Nations Environment Program's Finance Initiative "concluded that a failure to integrate ESG criteria constitutes a violation of fiduciary duty" and that "an increasing number of cases are being brought against pension funds pertaining to fiduciary duties and climate change."[14]

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[10] https://www.acf.org.uk/news/funding-on-a-finite-planet-carol-macks-speech-at-acf-conference

[11] Charities Responsible Investment Network (2021): Growth Narratives.

[12] https://www.gov.uk/government/consultations/charity-responsible-investment-guidance/regulatory-impact-assessment-guidance-update-on-responsible-investment

[13] UNPRI (2016): Fiduciary Duty in the 21st Century - UK Roadmap, p.6.

[14] Buller, A. (2020): 'Doing Well by Doing Good'? Examining the rise of ESG Investing. Common Wealth.

In practice, norms and regulation of investment are now advancing beyond ESG to explicitly address positive real-world outcomes. For example, The Pensions Regulator now requires pension trustees to address climate change or otherwise face enforcement, and has itself committed to setting a 2030 net-zero target and publishing a climate adaptation report before COP.[15] Climate change has also been incorporated into the mandates of the Bank of England, the Financial Conduct Authority and Prudential Regulation Authority, which oversee the investment and financial intermediaries used by most charities.[16]

The charity sector should be leading the way in ensuring that investment contributes to System Value, respecting and sustaining social and ecological thresholds. By presenting minimum standards as optional and ignoring the bigger picture, the draft guidance risks setting the sector up as a laggard.

Conclusion

The landscape of financial policy-making is rapidly catching up with the interconnected crises of our time. Pensions, asset management, banks and insurers are expected to proactively contribute to a just and sustainable future. The Charity Commission's review of responsible investment must ensure that the charity sector plays its part in the transition, and ideally models leading practice.

We welcome initial steps taken in the draft guidance to rebalance financial returns alongside charities' purposes and the public benefit. However, to support the charity sector to invest appropriately and ambitiously, a clearer and more confident link must be made with investment's real-world, social and ecological context.

Contact

We would be pleased to clarify or discuss any aspect of our submission. Please contact Dominic Burke, Lankelly Chase's Investment Director, at dominic@lankellychase.org.uk

[15] https://esgclarity.com/industry-welcomes-uk-pensions-regulators-new-climate-strategy/
[16] https://www.businessgreen.com/news/4029011/key-uk-financial-regulators-mandated-consider-climate-issues

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