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OUR FAITH IN THE PLANET

How Can I Invest My Funds Ethically?

This resource has been kindly shared by Jonathan Fenton -retired solicitor. EcoJudaism is very grateful for his expertise and generosity.

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This resource is being used to support the following two Audit questions:

Section 3 Lifestyle/Investment
Q: 14 - *Our Synagogue invests its funds ethically, and rates the ESG (Environmental, Social and Governance) sustainability of its portfolio.*

Section 3 Lifestyle/Home
Q: 6 – *Our synagogue encourages the ethical investment of personal savings and pensions.*

What is sustainable investment – an introduction:

There are a number of classifications of sustainable investment and a number of different approaches to this kind of investment. The practice has evolved over the last 20 years or so and the techniques and tools of analysis have become more complicated. The process has been driven by a number of key factors:

- Pressure from institutional investors especially pension funds and charities for a more accountable and long-term approach by the Board of companies in which investments are held.
- Acceptance by the Boards of major companies that behaving as good corporate citizens from an environmental, employee relations, community, supply chain, customer relations, societal and governance perspective is good for business in the long term.
- Increasing regulation which has driven ever greater disclosure by large companies in particular as regards the action which they are taking on ESG matters and on environmental action to help tackle climate change in particular.

- A sea change in public awareness of the importance of environmental, societal and governance issues (especially climate change and issues to do with preservation of the natural world) which in turn has led to an awareness of the role and influence of personal investment in these matters.

These notes are intended by way of general guidance and are not intended as a substitute for legal or investment advice. No specific investment advice is offered or intended in these notes. You should take your own investment advice from a person duly authorised to provide such advice under the FSMA 2000 as regards any specific investment you may have in mind.

Terminology and different approaches – a summary:

A confusing array of different terminology is used in this field e.g. “responsible”, “sustainable”, “ESG”, “ethical”, “green”. There are both similarities and differences in these concepts but none of them is a technical term. It is more helpful to consider a number of approaches which are commonly encountered in practice in the management of retail and institutional funds. These are not necessarily mutually exclusive approaches.

Exclusion:

With this traditional approach companies which operate in certain industries will be regarded as excluded from the available universe of investment on ethical grounds. This may be expressed in a number of ways either as incompatible with (say) the charitable aims of a particular organisation or as incompatible with a commonly expressed central principle that companies should only operate in fields which “do not harm” society or the planet or both. So frequently one will find excluded in this way companies which have a substantial part of their operations in the manufacture of weapons or in the production of tobacco or alcohol or in certain kinds of mining or (increasingly) in fossil fuel extraction.

There can be trustee duty issues for pension fund trustees and charities with the application of blanket policies of exclusion based on whole sectors of the economy. This is due to the need of larger pension fund and charity investors to ensure proper diversification of their investment portfolios. I will come back to this.

Preference or “best in class”:

Here, a blanket exclusion policy is not adopted but the Investor looks to invest in the portfolio companies which have the best ESG policies and operational practices in fields which might otherwise be excluded. So if an oil company is well run and has an excellent safety record and is working towards transformation into a renewable energy company

with a credible plan, the fact that it is an oil company will not bar it out as a candidate for investment or retention.

Responsible investment and stewardship

Here the idea is that investors (admittedly mostly the larger investors and the investment managers who represent them) will engage with the Boards of the large companies in which they invest. It will be part of the promotion of the long term success of the Company, so in shareholders' interests, for the Board to attach full weight to the environmental, societal community and governance impact of the Company's operations (a company law obligation in any event). This is in short a policy of enlightened stewardship by investors and of enlightened capitalism by both corporate boards and investors both institutional and retail. I would say this more holistic approach has become the favoured and dominant approach now.

Is there any kind of consensus or common benchmark for sustainable investment criteria?

Let me turn to sustainability criteria. The EU has done some interesting regulatory work recently in this area on disclosure and with a view to (i) improving disclosure for investors and (ii) countering "green washing". Green washing may be described as the practice of labelling a Fund with green credentials without substantive foundations as regards its investment parameters, processes or procedures. This trend among some investment managers has been driven by a wish to capture some of the tide of funds coming into ESG/sustainable funds over the last couple of years, including from those in their 20s and 30s who may be investing in funds for the first time and for whom investing with green credentials is a key priority.

Under the relevant 2019 EU Regulation (so part of UK law despite Brexit) both pre contract (e.g. in the key fund fact sheet) and on an ongoing basis (e.g. in periodic reports to investors) investment managers of discretionary investment portfolios and of investment funds will now have to disclose to investors:

"all relevant sustainability risks that might have a relevant material negative impact on the financial return of an investment.."

Investment managers will need to disclose sustainability risks where these "might impact the performance of the financial product in quantative or qualitative terms".

Investment managers will also be required to disclose whether and if so how they integrate sustainability factors into their investment decisions.

The EU Regulation's very comprehensive definition of "sustainable investment" is also very interesting and comprises the following elements:

- On environmental issues: an investment that contributes to an environmental objective especially to do with resource efficiency e.g. renewable energy, raw materials, water and land use, production of waste, GHG, impact on biodiversity, the circular economy.
- On societal issues: an investment that contributes to tacking inequality or that fosters social cohesion, social integration and labour relations; an investment in human capital or economically or socially disadvantaged communities.
- On governance: These are overriding criteria for all sustainable investments: (i) they must **do no significant harm** to any of the objectives referred to in the definition (ii) the portfolio companies must follow good governance practices as regards sound management structures, employee relations, remuneration of staff and tax compliance.

Anatomy of an investment fund – an overview for the retail investor:

An investment fund is a collective investment scheme, legally speaking. This is essentially a legal arrangement (commonly either a unit trust or an investment company) designed to facilitate the pooling of investors' funds for common investment. The objectives will be to invest the common property of the scheme (in the case of retail investment) with the benefit of professional investment management for a management fee in a range of well diversified stock exchange investments within the investment parameters set out in the Prospectus for the Fund.

Most commonly for retail investors the Fund will in summary be structured and regulated as follows. The mechanics matter because they affect the security of your invested funds just as much as the quality of the underlying investments and should be part of your or your adviser's due diligence.

- The type of fund will most likely be regulated and intended for retail investment as what is known as a UCITS fund. UCITS means in short a "common investment scheme for investing in stock exchange shares and securities". To qualify as such a scheme it will be subject to a range of controls as regards (i) the kinds of investments which are permitted – which for the most part will be limited to shares (equities) or securities (corporate or Government debt) quoted on recognised stock exchanges internationally (ii) the degree of concentration of investment which is permitted – so for example no one investment will be permitted to represent more than 5% of the value of the fund – which will provide some obligatory investment diversification (iii) limiting the extent to which derivatives (options and futures) can be used – generally just for efficient portfolio management and not for speculative purposes.
- A further set of regulations require that there be set out in the Prospectus for the Fund all the information which the prospective investor might reasonably be expected to find to make an informed decision as to whether to invest in the Fund.

This includes the risk parameters of the Fund calculated on a conservative basis and averaging out performance and market fluctuations.

- Few ordinary retail investors will perhaps ever read the full prospectus (though their investment advisers may do so). Investors are more likely to rely on a two page "key facts" sheet which as its name suggests sets outs the key investment parameters of the fund, its risk profile, some information about the Fund's annual and cumulative past investment performance and (where the fund has been going for some time) a list of its principal investments.
- So far as the dramatis personae of the Fund are concerned, the investment manager will be authorised by the Financial Conduct Authority as will the overseeing authorised corporate director of the Fund (like a Board of Governors). The Fund's investments will be held by an independent custodian, often a UK or US Bank which specialises in this function which will also be FCA regulated for this purpose. So, the investments of the Fund will be kept separate from the investments of the Manager. Uninvested cash (pending investment) will be pooled but also kept separate from that of the investment manager in a client account.
- The most common legal vehicle for retail investment in the UK and in many countries in Europe is the so called "open ended investment company". Investment funds of this kind are "open ended" because as an investor and shareholder in the fund you are able to encash your investment in the Fund at any time by giving notice to the investment manager. The Manger will then on a dealing day realise sufficient investments in the Fund to meet your call at the prevailing price which should be a fair reflection of your underlying interest.
- If there are problems with the liquidity of the Fund (e.g. potentially bad investments or some of the Fund's investments are in listed property companies), the Manager may put up a "gate" for a time to prevent a run on the Fund and to ensure fair play between those investors who want out and those who are in for the long haul.
- You will often find "umbrella" or "multi share" or "multi cell" investment companies for retail fund investment. All this means is that the investment manager opens up a new share class for investment to correspond to a different investment theme (so you won't have a renewables fund and a high tech fund in the same pot). The assets and liabilities of each share class will be ring fenced from one another with retail open ended investment companies which are UCITs compliant.
- In practice you will find in the Annual Report and Accounts ("ARA") that the Authorised corporate director (Governing body) and the auditor will give various formal assurances about compliance with the numerous rules about the proper running of the Fund. Of course beware if you can't find them!
- A word about documents for a Fund structured in the way I have described. You will commonly be able to find either on the website of the Manager or on one of the readily accessible investment platforms and without having to make any investment commitment: (i) the full updated Prospectus – which will also contain a summary of the constitution of the investment company and details of the material agreements relating to the Fund (ii) the last audited annual report and accounts of the Fund and

often an interim unaudited report and accounts for the last 6 months (iii) key fact sheet (iv) in some cases a stewardship report from the investment manager about how it has engaged with investment portfolio companies on ESG issues.

- These documents do enable you to drill down into the individual investments held by the particular fund in which you are considering investment. The key investor document will normally disclose the Fund's largest 10 investments by weight of money. But in the ARA you will be able to find the full list. Some companies make what you may consider "surprise appearances" in funds which have ethical credentials. Much will depend on the particular criteria which the investment manager applies in stock selection and on how strict these are.

Choosing investment funds and the relevance of sustainability criteria:

You only have to google "ethical funds" to come up with numerous adverts for investment platforms or supermarkets through which investment funds may be purchased directly. As a retail investor, you have a number of routes to the investment market in what has come to be known as the sustainable fund market. Which route you take I suggest will be determined by:

- How much you have to invest;
- How much you know about investments and the investment process i.e. how much prior investment experience you have.
- Your appetite for risk and risk tolerance.
- Whether you wish to spend time and effort on these issues or delegate the whole thing to a investment professional house under a discretionary management contract (naturally at a cost).
- Whether you have a good independent financial adviser.

Is my Investment Manager Green?

Whether you have a fortune to invest or quite modest savings, there is nothing to prevent you checking out the green credentials of the investment manager who is going to be looking after the funds you are ultimately going to entrust to that company.

Because of the way investment markets work, unless you are an angel or venture capital investor (and even then) you are very unlikely to have any direct engagement in the investment process itself. This is essentially because many of the advisory and dealing functions are highly regulated activities which you can't undertake in a personal capacity. You can certainly invest on your own account usually via an investment platform or trading account with a bank. But one way or another you are very likely to find that your monies are committed to some kind of investment fund or product of the kind I have described above. So the integrity and with ESG investment, the green credentials of the investment manager

are pretty important. A number of questions are worth asking of the Manager and should be readily answered by looking at the Fund Manager's website and promotional literature:

- Is the fund manager a signatory to the UN investment principles for responsible investment (see below).
- Does the fund manager integrate ESG factors into their core analysis both at asset allocation and at stock selection level?
- Does the fund Manager have an ESG advisory panel of experts?
- Can the fund Manager provide examples of where ESG factors have led to buy or sell decisions i.e. do they walk the walk as well as talk the talk?
- Does the Fund Manager comply with the UK Stewardship code for investors?
- Does the Fund Manager engage with the Companies in which client Funds are invested to improve corporate behaviour?
- Is the Fund Manager transparent about its voting record?
- Does the Fund Manager actively engage with the Companies in which client Funds are invested?

What role should my IFA play in all this?

One of the key things with IFAs is to make sure that they are truly independent in the advice which they provide. Financial advisers must disclose to the client or potential client whether they are tied to a particular company e.g. an insurance company so are only able to advise about the products of that particular company or whether they have to review the whole of the market when giving you advice. Similarly, the rules about disclosure of any commissions are very strict. Though I suppose it is possible to get some useful advice from a tied adviser, my own view is that it is far preferable to chose a financial adviser who is NOT tied to any particular company, who charges on a fee basis for the work done on a basis agreed in advance with you the client and who agrees to disclose to you and to rebate any amount received by way of commission for introducing your business against the fee charged.

Plainly an IFA so appointed will owe a duty of care to give you competent advice, to ascertain your tolerance and appetite for risk and to make recommendations of suitable funds in the light of your particular circumstances. It can sometimes be difficult to get cost effective investment advice of this kind for the investment of relatively modest sums. I am not sure where the lower cut off is, but it might be around £15,000 depending on the firm of investment advisers.

A good IFA should be able to provide you with holistic advice so that though ESG issues may be very important to you, you should not be blinded to the suitability of particular Funds from other viewpoints which are unrelated eg your investment horizons should be long enough to make the investments potentially worthwhile. An investment of between 3–5 years is not uncommon.

IFA firms will also usefully be able to simplify the ESG choices in terms of “exclusion”, “best in class” or “long term – integrated approach” which I cover in more detail in these notes and make specific recommendations about thematic and geographic coverage to reflect your desired risk profile for example as between equities and Govt and corporate bonds and particular thematic sectors. IFAs will be authorised by the FCA to make specific investment recommendations. The documentation and information from which they are working will be largely publicly available (see section on Investment Platforms). But the larger firms will have data bases about the main investment management firms which they will keep up to date and good market intelligence and experience which is naturally a valuable commodity.

Can I invest myself without taking advice? - A word about investment platforms:

It’s important to distinguish between “execution only” platforms which do tend to rate investment funds and their managers or carry over ratings from investment commentators on the one hand and the process of taking investment advice on the other, which I briefly describe above.

If you look at the commonly used investment platforms, you will find star ratings for investment funds. Needless to say, these can be very misleading. The main ratings tend to come from two financial news organisations, Morningstar and Trust Pilot. Morningstar provides a subscription market review service which covers stock exchange investments and investment funds. Its analyses are quite useful. They will allow you to “look under the bonnet” a little in terms of the qualities and history of the particular manager of the Fund in which you may be considering investing, the performance track record and the individual managers who are employed by the Fund manager whose investment track records may well be important. Individual investment managers can be a bit like star football players. Indeed the analogy between a good investment house and a good football team is appropriate because:

- It’s probably a mistake to invest with a House which is reliant on one or two “star” investment managers only because the issue is what will happen if they join a competitor or decide to go off and set up their own fund management business- there is a risk that the stellar performance will nosedive.
- What you should really look for is a large stable team with diverse skills where the reputation and performance of the investment house is the key thing.

Some platforms “tip” or recommend particular funds in the light of these star ratings or based on their own research. This is not investment advice and will be hedged about with disclaimers at the point of purchase to the effect that the investor is investing at his or her own risk and if in any doubt about the merits or suitability of the investment should take investment advice.

The degree of research undertaken by the Platform provider can be pretty cursory. For example, Hargreaves Lansdown for some years recommended investors to invest in Funds managed by Neil Woodford a well known City investment manager who at one time was a "star" investment manager with Invesco, a well known US investment house. The Woodford Funds collapsed in 2020 partly as a result of some illiquid investments made by the Fund Manager resulting in substantial losses for investors. There is now litigation also involving HG because of its recommendation of the Woodford funds.

Anatomy of a sustainable investment fund:

I have taken an example from a well known and respected investment manager in the sustainable funds space just to see how they describe their own sustainable investment processes in the light of these disclosure requirements. The key elements of what I think is quite a common approach in the industry where a manager has a well-established sustainable investment team are as follows:

- A statement about integration of ESG factors into the due diligence process for thematic (asset allocation) and stock selection decisions within the chosen fields of investment as ESG compliant.
- Narrow down the investable universe by excluding sectors which pose too great a sustainability risk in line with the broad definition of sustainability which we have just considered. So those sectors would not be compatible with the Fund's core investment criterion of "not causing harm to Society or to the environment". Arms manufacture, pornography, tobacco, and alcohol manufacture are then excluded on this basis.
- From the remaining investible universe, the investment manager aims to align potential investment areas with the Fund's sustainable themes of better resource efficiency; improved health; greater safety and greater resilience. Individual stocks are then rated against these thematic criteria and given a ranking. So, the Manager asks, does the core business of the particular proposed portfolio company help the environment or contribute to society and if so to what degree? Sustainability is then rated on a scale of A-E.
- A potential investment with a high rating is then considered on a separate governance scale on company management quality of 1-5 by reference to whether it has structures, policies, and practices in place for the effective management of its ESG risks. Only high scoring candidates on both matrices will be eligible for potential investment.
- On an ongoing basis, as we have seen when we looked at the engagement processes of institutional investors, one would expect to see an active stewardship/engagement program from a serious ESG manager which outlined the Manager's approach to shareholder engagement and voting so that as large investors with collective fund voting power on behalf of retail and institutional

investors the Manager also "walks the walk" on ESG issues. This particular manager reports thematically to investors by reference to priority ESG initiatives e.g. "encouraging sustainable use of plastics" and indicates what investment wise the Manager is doing to try and advance that objective which in this case is to look for companies in which to invest which provide solutions to plastic pollution and to monitor the actions of existing investee companies in the reduction of plastic waste.

- So as an individual investor, you won't have any real say on an individual company level (which is fair enough given the fund structure) but you will have a handle on what is going on generally speaking.

What about my SIPP investments - can I "green" these too?

Generally, the wide range of sustainable investment funds which can be taken up through ISAs can equally be adopted through the SIPP route. Investment considerations tend to be longer term from the individual's perspective because naturally you are putting funds away for your retirement on a money purchase (defined contribution) basis. But longer-term investment horizons should align well with many sustainable investment themes in terms of investment suitability. This is particularly the case given the so called "pension freedoms" as regards the ways in which retirements benefits under personal pension benefits may be taken as between retirement income and lump sum and the flexible period of time over which this is possible (especially in the window between age 55 and age 75). SIPP Investment strategy should be considered as a part of the individual's retirement plans in this regard, particularly due to the dominant trend towards phased retirement.

An example will illustrate the approach taken by some pension providers, taken from recent financial press articles. **No investment advice or recommendation is intended.**

Aviva: a large platform provider/administrator and trustee of SIPPs claims to have embedded ESG principles across its default funds. This insurer states that it aims to combine a responsible investment approach with the well-known risk management approach of "life styling" (so reducing investment risk by reducing the equity component of investment and increasing the bond component progressively) as the point of chosen retirement approaches.

Some Sustainable investment themes pursued by Investment Funds and the companies in which they invest:

I must here acknowledge a very comprehensive document prepared by the World Economic Forum "New Nature Economy Report" published earlier this year. The general message is that we are facing catastrophic damage inflicted on the natural world and loss of species and biodiversity, documented in great detail by the UN Committee on Climate Change. However, WEF's well reasoned view is that the change in human behaviour which is essential in many areas to ensure our own survival and that of nature brings with it huge

economic and business opportunities. This Report therefore points a strong way forward in connection with future sustainable investment particularly where pilot projects could be scaled up with more investment.

I will just pick some highlights from the WEF Nature Report which are relevant to sustainable investment.

- Government and industry should work together so as to promote a green recovery from the COVID 19 Pandemic. HMG has accepted this principle separately in its own published energy policy.
- We should move towards increasing patterns of **planet compatible consumption**. This involves: making food production compatible with the ability of the Earth to produce and replenish the resources needed to sustain human life; reducing meat production which is wasteful of land resource and can be substituted with plant protein; reduction of food waste, especially at the point of consumption. Examples of food waste reduction technologies are given e.g on offer to the restaurant trade.
- WEF identifies **transparent and sustainable supply chains** as one of the keys to ensuring healthier and more ethically sourced food and natural resources in a wide range of areas. One area relates to fisheries where there are numerous problems related to illegal and industrial fishing leading to the exhaustion of fishing stocks, a lack of co ordinated international regulation, quasi slave labour practices and seas polluted by plastic and in the process of acidification due to climate change. WEF identifies opportunities for the creation of marine conservation areas, high tech surveillance systems using GPS to track illegal fishing and to assist enforcement authorities and block chain supply chain processes to try and ensure a higher degree of ethical sourcing of fishing catches to the consumer.
- **Circular supply and re manufacturing chains:** Here the idea is that instead of consumer goods being manufactured with a view to obselesence and scrapping/landfill waste, the possibility of re cycling and re manufacture is designed into the product. WEF gives examples in the fashion and car industries where these processes are already in place though on a relatively small scale.
- **Nature positive mining:** WEF points out that demand for precious minerals in connection with battery manufacture is on the increase as motor manufacturers move away from cars based on the internal combustion engine. But there are ethical supply chain issues because deposits of cobalt, which is an essential ingredient in the manufacture of Lithium-Ion batteries, are mostly based on the African continent and in the DRC in particular. Again block chain technology is being used with on the ground verification to try and ensure ethical supply ie no use of child or slave labour in the mining process or of the proceeds to fund violent conflict.
- **Nature Positive Energy Transition:** This is plainly about the transition away from reliance on fossil fuels and towards reliance on renewable sources of electricity generation. WEF identifies land citing technology (using enhanced GPS) as a way of identifying suitable sites for the ever-larger solar power plants which will be required.

- More broadly WEF recommends the development of both positive Government subsidies to encourage energy transitions and nature positive transitions with integrated action maps and plans.
- So far as the "Nature's call to action" for business is concerned WEF recommends that each Company (especially those with extensive operations) (i) identifies which transition to a carbon neutral economy that Company can accelerate (ii) adopts best in class practices regarding nature positive business practices (iii) joins or creates multi stakeholder partnerships towards nature positive models. Various examples are given: (A) the retrofitting of old office buildings to improve the environmental footprint (B) sharing urban infrastructure to maximise efficiency and logistics and reduce emissions – this may apply to roads, railways, airports, agricultural machinery (B) blended finance: e.g. green bonds or blue bonds (see separate section).
- WEF is also a determined proponent of 4th Industrial revolution technology as an important set of tools under human control and subject to suitable ethical guidelines to contribute to better environmental outcomes. Examples are given in the fields of prediction of extreme weather events and precision agriculture in dry regions.

The Perspective of Institutional investors and why this matters to us as retail investors:

Large pension funds, insurance companies and to a lesser extent charity (with some notably large exceptions like the Wellcome Trust) have for well over 50 years been substantial equity and bond investors in Stock markets internationally.

Pension Funds and ESG investment issues:

On the pension fund side this was traditionally driven by defined benefit (final salary) pension schemes where the amount of the individual's retirement benefit had a link to his or her earnings in a set period prior to retirement. These schemes built up huge separate funds under the stewardship of Trustees to back these pensions promises. In the 1990s many of them were in surplus actuarially. But many of those that survive are in substantial deficit and have become substantial economic burdens on their employers as regards the funding of these past pensions promises. There are examples in the News in the University, Steel and retail sectors.

In the UK many of these pension schemes are found in the public sector (e.g. University or Local Authority) or in the former public sector e.g. the pension schemes of British Airways or British Telecom. This is a pattern repeated internationally.

The more modern kind of workplace pension scheme is a defined contribution or money purchase scheme. Here the benefits of the individual member are not linked to their salary. The benefits which they derive on retirement are determined solely by the level of contributions paid into the scheme by the individual and by his or her employer during the

period of membership and by the investment returns on those contributions. Your own personal pension scheme (e.g. a SIPP) will essentially work in the same way. Some of these schemes can also be very large e.g. NEST. Usually in defined contribution schemes of this kind as a member you will be given some thematic choice by the Trustees about the way in which the contributions made by you and for you by your employer are invested. There will commonly be an ethical fund of some description and the larger schemes like NEST will have more refined choices here.

So, these pension schemes are very substantial investors in Stock markets around the world. They have legal duties to maximise the returns on scheme investments, to ensure the suitability and diversification of investments. Above all they are long term investors if you think about the long-term nature of the retirement liabilities.

That's why these investors are so concerned about ESG issues, especially climate change risks which face the companies and indeed Governments in which they invest and to whom through the bond markets these investors are in effect providing finance.

Put another way negative impacts on society or the environment which arise as a result of a company's core business, products or services are often seen as a source of financial, legal regulatory and reputation risks. These can threaten the reliability and even the future existence of the company which has previously generated the healthy returns on which institutional investors rely. Lots of examples come to mind:

- Boohoo: the online fashion retailer recently suffered substantial falls in its share price due to alleged quasi slave labour practices by its sub contractors within its supply chain.
- BP: suffered huge losses, fines and liability for civil compensation in respect of the Deep-Water Horizon Louisiana Oil spill in the Gulf of Mexico in 2010, apparently due to BP's negligence in the oversight of its engineering processes in respect of the capping of underwater oil wells: Financial impact for BP est US $61bn.
- Carillion: went bust in 2018 having over reached itself in undertaking too many construction contracts (many for the public sector) on uneconomic terms;
- VW Emissions scandal: The car manufacturer suffered fines and liability to pay compensation in respect of the manipulation of emissions tests on diesel vehicles (ongoing from 2015)
- Facebook/Cambridge Analytica: Facebook sold on customer data to an academic who in turn unlawfully disclosed this data to CA which used the data to give unlawful electoral advice to political parties. Huge reputational and financial damage to Facebook. CA went bust and director of CA disqualified.
- Deliveroo: recently we have seen institutional investors shun this new flotation due (in part) to concerns at the unethical self employment practices deployed by the Company in relation to its delivery "workforce".

So, the duties of pension scheme trustees which I have described are consistent with being climate aware and generally ESG aware about investment risk. Institutional investor

groupings (e.g. the Pensions and Lifetime Savings Association) and the Institutional Investor Group on CC are seeking systematic ways in which they can reach a carbon neutral position in relation to their investment portfolios at a chosen date depending on the composition of the portfolio between 2030 and 2050. They are seeking to do this not so much from a moral position. Indeed, the case law is clear that pension fund trustees are required NOT to take moral stands on investment matters, purely as matters of conscience, irrespective of the financial consequences for the scheme. No, their concern will be to mitigate the long term financial and investment risks for the portfolio in exposure to:

- Excessive investment in fossil fuel companies whose assets and operations may end up being "stranded" by tighter regulation, lack of consumer demand or unsustainable competition from renewable sources of energy.
- The consequences of loss of biodiversity (see the section below on nature positive investment).
- Poor governance and reputational issues to do with the way particular companies may be run or operated.
- Societal inequalities emerging from the operations of particular companies especially in the developing world.

Pension fund trustees are now legally required to report annually to their membership on the extent to which they take into account ESG issues in the exercise of their investment powers.

Charities and ESG investment issues:

In **The Bishop of Oxford v the Church Commissioners (1992)** the High Court decided that there were limited but important circumstances in which charities could have regard to ethical or moral considerations as regards investment matters as follows.

- Where the objects of the charity were such that it was clear that investment in particular kinds of company or business would be in conflict with /repugnant to the aims of the Charity. So, a cancer charity could lawfully rule out any investment in a company which manufactured tobacco products and a charity which promoted peace or conflict resolution could rule out any investment in a company which was involved in the manufacture or sale of arms.
- Where holdings of particular investments due to the nature of the business or due to reputation issues might hamper the charity's work by alienating those who might otherwise be donors to the Charity or who might otherwise volunteer their services to it or become trustees of it.

Equally the Court made it clear that it was not open to Charity Trustees to use charity investments to make "moral statements at the expense of the Charity".

We can still see this reflected in the current investment policy statements of the Church Commissioners today. Their 03 2017 statement of ethical investment policy is a well-

developed modern responsible investment policy, consistent with UN responsible investment principles. Interesting points to note:

- Stewardship and active engagement with companies in the portfolio is strongly emphasised. It is often said that investors have far more influence in this way than through actual or threatened divestment of their shares if the Board of the Company concerned is not persuaded on a particular point. A number of environmental charities disagree with this view e.g. Friends of the Earth. Divestment remains the ultimate sanction, though of course there will always be a willing buyer for the shares in a functioning stock market.
- There are some investment exclusions in the Church's investment policy in line with Christian values, as originally advocated by the Bishop of Oxford back in 1992. So the Church states that it does not wish to profit from or provide capital to activities which are materially inconsistent with the Christian faith or which could undermine the credibility, effectiveness or unity of the Church. So, with that in mind there is a list of exclusions, kept under periodic review. These are businesses involved in: arms, pornography, alcohol, tar sands extraction or thermal coal (re climate change).
- The Church Commissioners have an expert Advisory Panel on ethical investment issues (an approach commonly adopted by many of the leading investment managers in the ESG space).

The Church Commissioners provide an interesting model in line with modern practice for large faith-based charities with substantial investment funds and endowments.

The power of collective action by Institutional investors:

I will deal with this briefly. There are a number of institutional investor groupings (Climate Action 100, the Institutional Investor Group, the Pensions and Lifetime Savings Association). These are more than "trade bodies". They are positive advocates and agents for change on ESG issues with the Boards of the companies in which they invest. As these are often some of the largest companies in the world, these initiatives can make a real difference.

One example is the United Nations Principles of Responsible Investment of which there are over 2,500 institutional investor and investment manager signatories representing assets under management of nearly US$ 90 Trillion. Briefly the Principles are:

- Incorporate ESG issues into investment analysis and decision-making processes.
- Be active shareholders and incorporate ESG issues into investor ownership policies and practices.
- Promote appropriate disclosure by portfolio companies about ESG issues.
- Promote acceptance and adoption of the principles themselves among investors and in the investment management industry.
- Work in collaboration to enhance the effectiveness of the principles.

Institutional investors and UN Sustainable Development Goals:

In 2015 the United Nations adopted an international plan for the implementation of the SDGs by 2030. Put very shortly the SDGs are as follows:

- Elimination of poverty.
- Elimination of hunger.
- Good Health and well being.
- Quality of education.
- Gender equality.
- Clean Water and sanitation.
- Affordable and clean energy.
- Decent work and economic growth.
- Industry, innovation and infrastructure.
- Reduction in inequalities.
- Building sustainable cities and communities.
- Responsible consumption and production.
- Action on climate change.
- Preservation of ocean life.
- Preservation of biodiversity.
- Peace and justice and strong institutions.
- Building partnerships to attain the goals.

The UN has been keen to recruit large international companies and to interest institutional investors in the pursuit of these ambitious goals. The detailed 2015 UN Resolution which sets out a framework plan for the attainment of these goals for 2030 recognises that there are huge obstacles in the path of many developing nations' ability to attain many of the SDGs.

Some of those identified are:

- Corrupt local Governments i.e. an absence of strong institutions;
- Government policy which encourages environmentally damaging business and development (e.g. in Brazil);
- Societies where there is no peace i.e. where there is conflict and violence
- Economic deprivation.
- Patriarchal societies.
- Economic exploitation by stronger countries of weaker resource rich countries (e.g the relationship between China and certain parts of Africa).
- Entrenched poverty with multi factor causes.

So what's this got to do with ethical investment?

Institutional investors collectively through the auspices of the UN Principles for Investment movement are beginning to pressure the companies and Governments within their portfolios (i.e where the investors own equity and debt securities on a "universal" basis) to look at broader outcomes of their activities in SDG terms. Under the framework which the PRIN organisation recommends, large pension funds and charities would:

- Identify outcomes.
- Set policies and targets.
- Seek to influence outcomes by engagement with the Boards of the companies involved.
- Act in concert with other "global stakeholders" to seek outcomes which are in line with the SDGs. So, this could mean working with NGOs, Governments, Universities carrying out relevant research and with business.

So, what does this mean in practice? An example is given of institutional investors owning a brewing company with a high need for water in its industrial processes operating in a region of high water stress. The investors could engage with the Company to provide projects of social benefit to the local community as part of the price of water extraction (e.g local water purification projects) where the portfolio company might be working with specialist businesses, social enterprise, the local community and with NGOs. There are examples of this in India.

In practice some of the leading investment managers in the ESG space are reporting to their clients on stewardship issues by reference to the advancement of SDGs.

Public companies and ESG issues – Board and individual director responsibilities:

Why should I be interested in this as an individual investor?

The corporate world is a key partner in the green recovery process, a key agent if you will in the myriad practical ways in which with energy and enterprise, Government, NGOs and business together can try and repair the world, at least to some degree. My personal view is that the corporate sector is not "the enemy" but a series of partners with legitimate aims and expectations to be engaged with– partners with huge resources. Many large companies are leading the way here and wish not only to burnish their credentials but actually to embed ESG issues in their DNA.

Examples:

Carlsberg – work in India funding local water purification projects.

Fairphone – a Dutch mobile phone company – work on clean supply chains in Africa re mining of cobalt.

Unilever: Sustainable supply chains in connection with the planting and harvesting of tea.

BP: (Yes BP!) Transformation into a major renewable energy company.

This is very much underpinned by the legal position of Director Boards especially in the UK, but also across the common law jurisdictions. Let's look at the position of large companies as their businesses and operations are at the centre of environmental, societal and governance debates. The relationship between their Boards and their investors large and small i.e the process of shareholder and wider stakeholder engagement has received a great deal of attention in recent years, much of it to do with ESG issues and the direct or indirect impact of climate change in particular. The degree of disclosure required of large companies on climate change risks faced by them in their businesses and operations has also markedly increased under investor pressure and is set to increase further due to regulation.

Things you should know about the duties of Directors on company boards if you are an investor, but especially if you are a Director!

We should start with the legal duty of the Board of Directors to promote the success of their Company which under company law is framed in very particular terms. This duty is effectively supplemented by additional obligations which apply to listed companies (i.e ones quoted on the London Stock Exchange) under a corporate governance code and related guidance. Strictly speaking the Governance Code applies on a "comply or explain where you are not compliant" basis. So, the Code is not hard law but there is still a strong investor and market expectation of compliance.

The central company law duty on directors to promote the success of the company in the terms I will outline below applies to companies whether quoted on the Stock Exchange or privately held (there can of course be some very large private companies e.g those part owned by Private Equity (venture capital) houses. Directors have to carry out their role in good faith in the manner most likely to promote the success of the company for the benefit of its shareholders. Note that in the case of companies set up for commercial purposes, it is the financial interests of shareholders which are paramount.

In seeking to fulfil this overriding objective, the Board (in effect each director) is required to have regard to a range of factors as follows:

- The likely consequences of any Board decision in the long term: So strategically the emphasis of the Board will be on the long term financial sustainability and viability of the Company's businesses.
- The interests of the Company's employees (there might be a works advisory panel or an employee representative director).

- The need for the company to foster the Company's business relationships with suppliers, customers and others: We have seen how vital it is for companies to understand the ethics behind their supply chains. Large companies devote considerable resources to this.
- The impact of the Company's operations on the community and the environment. I will look at this in detail below.
- The desirability of the Company maintaining a reputation for high standards of business conduct.
- The need to act fairly between shareholders including shareholders of different classes who will have different rights and not to behave in an oppressive way to minority shareholders for whom there are separate protections in company law. I deal with the position of individual shareholders below.

Separately, under the Governance Code in the case of SE listed companies and certain very large private companies, the Board has an obligation to assess and identify current and emerging risks related to the objectives and strategy of the business and to ensure that an appropriate risk management plan is in place in that regard.

Let's focus on those aspects of these duties which impact mostly on ESG issues. I will take environment first.

Directors have a duty to assess the risks of climate change as they may affect the business and strategy of their company, to consider what steps can be taken to control, insure or otherwise mitigate those risks and to put in place suitable risk management plans.

Climate change may affect **and make vulnerable at different times** many different kinds of businesses and sectors. Examples from the literature:

- Agricultural and food related businesses, including supermarkets due to loss of biodiversity, pressure on international food supply, drought and deterioration of crop yields due to extreme weather events and changing season patterns spoiling predicted harvests.
- Fishing and related businesses: due to ocean pollution and acidification, over-fishing, illegal fishing and disputes between countries over fishing rights.
- **Real Estate and Housing:** Inability of housebuilders to build on flood plains due to increased risk of flooding an impossibility of householders obtaining insurance;
- **Insurance:** difficulty of assessing and pricing risks due to the intensity, frequency and unpredictable nature of extreme weather events.
- **Businesses which rely on the availability of natural resources for manufacturing:** oil and gas, coal, precious metals, used especially in the production of batteries for electric vehicles and bikes, wood and forestry (destruction of the Amazon rainforest – which perhaps will begin to slow if the US and Brazil can agree a generous enough aid/incentive package), palm oil, soya bean and meat.
- **Businesses whose core activities are not regarded from a climate change point of view as having any long-term future, indeed whose very existence is increasingly**

seen as a major threat to the survival of the planet. Opinions will vary as to which industries to put into this category but most would include the Oil Industry, natural gas and other fossil fuel industries (so coal mining). Others would include the commercial meat industry.

- **Banks:** who may have companies in all or any of the above sectors in their client base and be exposed as lenders.

Boards could be in dereliction of their duties to the Company and potentially personally liable as directors if their fail to take action to consider and take reasonable steps where possible to mitigate specific environmental risks which the Company may face in its business operations.

Director duties though strict are not absolute – the law does allow some reasonable leeway.

Of course, the above are not the only duties which are imposed on directors under company law here. Each Director will also owe an obligation to the Company to exercise reasonable care, skill and diligence in the performance of his functions. If a Director has any particular skills or qualifications (e.g. financial, legal or scientific) they are required to bring those to bear in the exercise of their judgment as directors. That said, the law also recognises that there is a range of decisions which a Board might reasonably take on any given set of facts within these tests, sometimes known as the "business judgement rule".

In practice in the case of large companies, there are (or at least should be) well developed committee and risk management structures for the assessment, identification, and management of risks relevant to the Company. Ultimately not all risks can be eliminated and it will be for the Board to decide both its appetite and outside tolerance for incurring risk in line with its business strategy, including where there is an environmental impact to the Company's operations.

The Government is proposing in a recent White Paper that Directors' duties for listed and other large companies be made more stringent, especially as regards the accuracy of Company Accounts, to guard against incompetent or negligent directors. This follows a number of recent high profile corporate collapses.

Reporting to shareholders, stakeholders and to the wider public:

Listed companies i.e. those whose shares are quoted on a recognised stock exchange either in London or around the EU are required to produce an annual report and accounts under a set of what for the moment at least remain common and very detailed reporting standards. These include a strategic report which forms part of the report of the Directors to shareholders. This report is required to detail how the Board has set about fulfilling its duty to promote the long-term success of the Company for the benefit of shareholders in the

sense in which I have described above. Part of this narrative is to comment on the principal environmental risks and issues facing the Company in the year reported on and looking ahead. Increasingly major companies view their annual reports and accounts as opportunities for major investor and wider public engagement on these issues. Specifically, the strategic report should cover:

- The Company's objectives and business model.
- The main trends and factors affecting the business.
- Financial performance in the relevant period.
- Major risks and uncertainties affecting the business.
- Environmental, social, community and any human rights issues.
- Gender diversity, both on the Board and in the workforce.
- It is required to be written in clear and accessible terms.

Increasingly, large companies use the publication of their ARA as investor and stakeholder communication documents. These not only comply with the very detailed requirements of company law and the Stock Exchange but also aim to give a sense of the Company playing its role as "good corporate citizen" especially with regard to ESG issues. (Again, without intending any investment recommendations) I would cite Barclays Bank plc, J Sainsbury plc and Unilever plc as examples of good practice here. Unilever, a noted market leader on ESG matters, notably has recently afforded its shareholders an advisory vote on its own plans to become a net zero company as regards its international operations by 2030 and in relation to its own supply chain by 2039.

Specific issues to do with Climate Change, disclosure by large Companies and the "Financial Disclosure Taskforce on Climate Change ("TCFD")":

Institutional investors and the investment management community long ago realised that climate change with all its uncertainties has brought with it major valuation uncertainties for portfolio companies within the investment portfolios of large and small investors alike. The Boards of these companies are under various obligations:

- To try and identify the major current and emerging risks facing their companies from a strategic perspective.
- To pursue strategies which are likely to promote the success of the company for the benefit of its shareholders in the long term taking account of (amongst other factors), the impact of the Company's operations on the environment and indeed vice versa i.e. the impact of environmental factors on the business of the Company.

So a global approach to the proper disclosure of those risks by companies whose shares are publicly traded was required and was developed in New York in 2017 by a special Task Force on climate change related financial disclosures. A set of disclosure principles has been developed under which companies whose shares are quoted on recognised stock exchanges around the world are encouraged to make disclosure (principally in the their

annual reporting documents) and at both strategic and operational level of the precise nature of the climate change related risks they face and of the risk management plans and mitigation measures they have put in place together with any additional governance arrangements in relation to these risks.

One fundamental purpose of these disclosures is to enable the market to price in these risks. The system is known by the acronym "TCFD": "task force on climate change disclosures". In due course, it will become mandatory for the reporting of UK premium listed companies and the Government has consulted on its application to disclosures by large pension funds.

But this is all very frustrating – how much influence can I have as an individual investor on green issues in my investments?

Now the degree of influence which you can have as an individual saver/indirect investor is admittedly considerably more limited than that wielded by the large institutional investors both individually and collectively. There are a number of reasons for this, some more obvious than others.

- With Fund investment there are intermediate layers between you the retail investor and the ownership of the underlying investments. This is necessarily the case because as we've seen funds work on the basis of a pooling of the resources of multiple investors with a resultant fractional ownership of the underlying investments through a custodian and an investment manager (see above).
- Even with direct holdings by retail investors of individual Stock Exchange quoted shares, shareholder voting in listed companies is democratic. But it is naturally weighted according to the size of each investor's holding. Resolutions which are put to shareholders will generally require an ordinary resolution namely a bare majority of votes cast (e.g the appointment of directors) with certain corporate transactions requiring a special resolution (a minimum 75% vote in favour). Strategy, including strategy on ESG issues, will be delegated to the Board of Directors who also have responsibility for the preparation and signature of the Annual Report and Accounts.
- AGM agendas tend to be quite tightly controlled by the Board. So, the opportunity for an individual shareholder to raise issues (say a concern about supply chain ethics or particular employment practices within the Company) may well be very limited. That said, the more modern attitude of the Chair - person of a large listed company is likely to be to allow questions to be put which are relevant to the company and to try and address them, whether or not they are strictly AGM business, so as not to be seen to be stifling shareholder concerns.
- Shareholders do in certain circumstances have the right to propose resolutions at shareholder meetings. But the support of not less than 5% of the shareholder by weight of shareholding is required for such a resolution to be put. In the case of a listed company, this could be difficult to obtain.

All this said, there are action groups of individual shareholders which seeks to raise issues of concern to individual shareholders. One of these groups is ShareAction. This Group periodically analyses the voting records of large international institutional investors to see whether they "walk the talk". In their 2019 report this Group found that there were major discrepancies among some of the large US and European investment houses between their supportive public statements about the importance of green issues in their investment policies on the one hand and on the other their voting behaviour when it came to particular climate change related issues within portfolio companies. The major investment houses claim that this has improved as they have ramped up their stewardship/responsible investment teams in response to the high profile nature of these issues and the demands of investors.

Banks and Green Finance:

Major banks are naturally conscious of their environmental impact. This arises both directly as regards their retail banking operations in the High Street, where of course in the UK they are trying to reduce their physical estate and in their commercial and investment operations. Banks which are incorporated in the UK, many of which are also listed companies on the London Stock Exchange, will be subject to the same rules and governance codes as other listed premium companies which I have explained above.

So, the question "Is my Bank a green one?" is not straightforward. I suggest that a starting point would be to look at the Directors' Report from the last published ARA which will most likely have a section in on ESG issues. The Bank's Board will have to report in this document on the way in which it has fulfilled its duty to promote the financial success of the Bank for the benefit of shareholders having regard amongst other matters to the Bank's environmental, community and reputational impact and as regards its relationship with its customers. The kind of questions which it would be sensible to ask and will doubtless be answered in a Report of this kind are:

- What is the Bank's plan to reach net zero for carbon in relation to its own retail operations and by when?
- What is the Bank's lending policy as regards client companies which are engaged in businesses which are a potential threat to the environment? A number of banks are still subject to criticism for lending to companies (outside the UK) which generate their revenues from fossil fuels. (Remember that with very limited exceptions, in the UK electricity is no longer generated by coal powered power stations.) The main environmental charities also campaign on these issues.
- A major step forward was also taken here by institutional investors on 19-4-21. The Institutional Investors' Group announced a range of expectations for the Banks in which they are major shareholders. These are (I) a request that Banks commit to becoming net zero by 2050 with a clear timeline and interim targets for achieving that ultimate goal (ii) the implementation by Banks of "just transition" policies eg as

regards corporate clients of the Bank transitioning away from fossil fuel industries or dependence towards cleaner forms of energy (iii) Banks to impose explicit net zero commitment related conditions in their lending documentation to corporate clients and in the issue of corporate bonds (debt on the public markets) again to drive towards a 2050 net zero target (iv) various detailed measures to scale up green finance.

- What is the Bank's code of conduct in relation to ethical behaviour and how is this enforced as a risk management matter? Remember though that Banks will be highly regulated in their activities by the Prudential Regulation Authority which will itself impose high standards of conduct (though this does not prevent breaches of the rules occurring from time to time).
- It may also be easier for a purely retail bank (i.e. one with no investment or commercial operations) to trumpet green credentials than a complex Banking group with say a commercial lending and an investment banking arm.

Green Bonds:

A very brief word about these. Essentially, they are money raising securities issued often by a Municipal or Local Authority of a large City or region of a Country with a view to financing a particular infrastructure project which is of environmental significance. Some examples from the USA are:

- A bond issue by the City of Washington to finance improvements to its water drainage system.
- A bond issue by the state of Miami to finance improvements to its flood defences.
- A bond issue by the state of Florida to finance nature positive and other improvements to the flood defences of that state.

Terms for green bonds have been more standardised in recent years.

We are beginning to see the emergence of "Blue bonds" to finance investment in acqua culture and fisheries conservation, so far financed by Governments and the World Bank rather than private capital as far as I am aware.

Impact Investing:

There are two main strands to this. The first concerns charities. This is where a charity applies charitable funds *either as a direct application of charitable funds for its core charitable purposes* or with a dual purpose in mind so partly for the return which the funds will generate and partly for the charitable impact which it is considered will result (social investment) so long as this is within it charitable purpose. Common applications are in the field of social housing.

This kind of investment by charities tends to be very long term and illiquid in nature i.e committed over a fixed term for a particular project. It follows that there is unlikely to be any kind of secondary market in investments of this kind which tend to be restricted to the charity sector.

The second is a branch of venture capital investment. Here there is a pooling of funds by socially minded entrepreneurs under either an investment partnership structure and/or a social impact bond. The idea is to make an investment which may produce an investment return, but which also has an objective doing some societal or environmental good. So, an investment in a company whose business is to supply healthy meals to schools would be an example. The classic social impact bond is normally a public private partnership. One of the first in the UK was concluded in Peterborough where the performance success of the bond in social impact terms was judged by reference to the re offending rates of offenders released from Peterborough Prison.

The higher risk profile of investment in this area is likely to make it less available for the retail investor due to regulatory restrictions.

"Impact investing" has attracted a lot of interest in recent years and has been heavily promoted by Sir Ronald Cohen a retired venture capitalist who wrote an interesting book about it. There are also Impact Investing Associations in the UK and in the US. UK pension funds are becoming interested in investing in this field.

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