STANDING COMMITTEE

Ethical Investment

At General Synod 2019, the provincial Investment Committee brought forward a motion to update the Ethical Investment Policy applicable to the Unit Trust Pool to reflect the use of pooled funds. The motion proposed to Synod read as follows:

"That

- *the Ethical Investment Policy be updated to reflect the use of pooled funds whilst respecting the need to subject investments to ethical screening and reporting;*
- *pending agreement of a revised Ethical Investment Policy the Investment Committee be permitted to transfer all or part of the current segregated ethically screened fund to appropriate pooled funds subject to Standing Committee's approval of the policies of any proposed pooled funds."*

Immediately prior to the commencement of Synod, an alternative motion was received under Rule 10 of the Synod's Rules of Order. That alternative motion read as follows:

"That:

- *The Ethical Investment Policy be updated to reflect the moral imperative to divest fully from fossil fuels and to extend the list of restricted categories for direct investments and pooled funds;*
- *Pending agreement of a revised Ethical Investment Policy, the current Ethical Investment Policy be retained; and*
- *There be formed an Ethical Investment Advisory Group to develop a strategy to enable the SEC to completely disinvest from unethical sources of revenue."*

After debate, Synod opted not to adopt the Investment Committee motion and instead approved the motion brought under Rule 10.

Following the meeting of Synod, the Standing Committee gave significant time to considering the implications of the motion which had been passed. Discussions took place with the proposer of the motion and with members of the Investment Committee. Standing Committee arranged for investment consultants from Mercer (who also advise the Pension Fund Trustees) to lead an informative and thought provoking seminar at General Synod Office in December 2019 to which a wide range of individuals were invited, and which looked at various approaches to the subject of ethical investment. Standing Committee also proceeded to create the Ethical Investment Advisory Group (EIAG) requested by the motion. There follows in the Synod Papers the Interim Report produced by the EIAG which details both the remit and membership of the Group.

The Interim Report was discussed by Standing Committee at a meeting in September 2020. The Committee expresses its grateful thanks to Alan McLean QC, the Chair of the EIAG, and its members, for producing such a thorough and thoughtful report and which recognises the complexities of the issues which arise when considering questions of divestment and ethical investment.

Amongst other things, the report outlines the EIAG's discussion of the issue of divestment from fossil fuels. Without repeating at length in this paper the details of that discussion, the Standing Committee noted the clarification sought from Baillie Gifford, the Unit Trust Pool Fund Manager, on the extent of direct, individual investment held in the UTP in companies that generate more than 10% of their turnover from extracting fossil fuels from the ground. They reported that as at 31 December 2019 the value in the UTP so directly invested was £92,715.72, being a holding in Total, a fossil fuel extraction company. That represented 0.35% of the directly-invested funds in the UTP, under the relevant Baillie Gifford strategy. Standing Committee was pleased to note that the investment in Total is no longer held and that the UTP therefore has no direct investments in companies engaged in fossil fuel extraction. Baillie Gifford have been instructed that no further direct investment by the UTP should be made in such companies in future.

Standing Committee commends the report to Synod for the latter's consideration. As will be apparent from the report, the work of the EIAG is as yet far from completed. To help it shape its ongoing work the EIAG would welcome comment from Synod members on the report and its work to date.

Robert Gordon
Convener, Standing Committee
October 2020

INTERIM REPORT OF THE ETHICAL INVESTMENT ADVISORY GROUP

Executive Summary

The interim report summarises the work undertaken by the Ethical Investment Advisory Group (EIAG) in its first year. It sets out progress to date and identifies where further work is needed.

Since its first meeting in February 2020, EIAG has progressed work in all four areas of its initial remit:

- **Review the current range of thinking on the ethics of investment (section 3).**

EIAG identifies both basic principles and the complexity of ethical investment. EIAG suggests the need to develop for the SEC a wider ethical policy than ethical exclusions alone, which involves seeking ethically positive investments, engaging with companies and fund managers where possible, and divestment where deemed necessary.

- **Define 'divestment from fossil fuels' for the purposes of the UTP (section 7).**

The SEC Unit Trust Pool is a fund in which investments (whether direct or pooled) for many parts of the SEC are managed so as to generate a reliable return to fund various aspects of the SEC's regular work. EIAG recommends that the immediate focus should be on the exclusion from the UTP of companies involved in the extraction of fossil fuels, but that industries that are users of fossil fuels, particularly in relation to burning of fuels, should form part of the ongoing discussion.

- **Make recommendations on the use of pooled funds for the UTP (section 8).**

EIAG concludes that the use of pooled funds for a relatively small fund such as the UTP is a pragmatic solution that addresses a number of investment criteria and administrative issues. EIAG identifies the need for a practical framework for making decisions about which pooled funds to invest in. These include how to determine whether a specific pooled fund is a suitable investment, and how ethical concerns about individual holdings in pooled funds will be addressed in future.

- **Propose a timescale for implementation of changes to the UTP (section 9).**

During the course of the year the direct holding in the oil and gas company Total was sold, and direct investment in all fossil fuel extractive companies added to the list of exclusions. However, this exclusion does not apply to pooled funds. Having agreed to recommend the use of pooled funds in the UTP, EIAG accepts that it would not be possible to set a timescale for changes to pooled funds held in the UTP until the proposed framework on the use of pooled funds is in place.

In considering options that could be appropriate for the UTP, EIAG reviewed how other UK churches and charities have approached fossil fuel divestment, and how they have achieved or are working towards their goals (Appendix). It notes the SEC's high level of dependence on the UTP as a source of income, and the relatively small size of the UTP compared with funds held by other organisations (section 5 and

Appendix). These factors may limit SEC's investment options. EIAG has also reviewed the current range of ethical pooled funds that might be suitable investment vehicles for the UTP (section 8(d)). EIAG acknowledges that the ethical investment environment is evolving rapidly, and that there have been new developments since the research for this report was carried out in the Spring of 2020.

This report aims to demonstrate EIAG's commitment to achieving fossil fuel divestment in the UTP. It is seeking a practical solution that takes into account ethical imperatives and investment criteria.

1. The Ethical Investment Advisory Group

Following a debate at General Synod in June 2019 and the passing of the rule 10 motion requiring this to be done, Standing Committee of the Scottish Episcopal Church ("SEC") has established an Ethical Investment Advisory Group ("the EIAG"). The EIAG has the following membership:

Alan McLean QC, Chair
Gordon Arthur, Member, Investment Committee
Dr Donald Bruce, Member, the Church in Society Committee
The Revd Amanda Fairclough, Priest in Charge, West Highland Region; Member, Investment Committee, Personnel Committee and Administration Board
The Revd Diana Hall, Rector of St Anne's, Dunbar
Andrew Hunter, Member, Investment Committee
The Rt Revd Andrew Swift, Bishop of Brechin
Simeon Wilton, formerly Intern, St Paul's & St George's Church, Edinburgh
The Revd Jenny Wright, Associate Priest, Christ Church Morningside; Convener of the Church in Society Committee

Administrative support has been provided by the SEC General Synod Office, particularly in creating the Appendix to this report, and is gratefully acknowledged by the EIAG.

2. Remit of the EIAG

The initial remit of the EIAG, set by Standing Committee, is as follows:

To make proposals for the revision of the ethical investment policy for the SEC's Unit Trust Pool ("the UTP") and to produce an interim report in time for General Synod 2020 ("GS 2020"), to include:

- a stand-alone paper setting out the current range of thinking on the ethics of investment for inclusion in the papers for GS 2020;
- proposals for a definition of 'divestment from fossil fuels' for the purposes of the UTP;
- recommendations on the use of pooled funds in the UTP; and
- a proposed timescale for the implementation of changes to the UTP.

This paper, with its Appendix (which is the "stand-alone paper" mentioned at the first bullet point above), constitutes the EIAG's interim report to GS 2020.

Following GS 2020, the EIAG is to proceed to provide:

- proposals for a definition of 'unethical sources of revenue' for the purposes of the UTP; and
- recommendations on a framework for considering and implementing other investment criteria to include any proposals for future investment restrictions and impact investment.

The remit of the EIAG notes the complex issues involved in these matters and obliges the EIAG to take account of the following:

- the wide range of views held by those having an interest in the UTP, including boards, committees and individual members of the SEC on how to respond to climate change;
- the implications for the SEC of increasing the current investment restrictions, including costs, investment risk, volatility of income and their potential impact on the work of the SEC; and
- the ongoing work of shareholder engagement by the Church Investors Group (CIG), the Institutional Investors Group on Climate Change (IIGCC) and other denominations.

The EIAG remit does not cover:

- The SEC Pension Fund. This is the responsibility of the Pension Fund Trustees.
- Investments managed by other fund managers on behalf of congregations and dioceses.
- The selection of fund manager or funds for the UTP. UTP investment strategy remains the responsibility of the Investment Committee.

3. Context – What does Ethical Investment mean?

The investment world is seeing an ever-increasing emphasis on the need to make financial investments not simply to maximise returns, but also with a strong commitment to ethical values. A 2020 Morningstar survey found that sustainable funds were performing at least as well and often better than traditional funds.[1] [2] The awareness of the responsibility on investors to ‘do good’ and not harm with the monies they invest has become mainstream, and the churches have been playing a significant role. Increasing scrutiny is being given to companies over their ESG performance (Environmental, Social and Governance). ESG encompasses a wide range of ethical social and environmental issues including human rights, labour conditions, modern slavery and gambling.

But the most prominent catalyst in this sea change is climate change. There is a belated recognition that the urgent global need to reduce radically the extraction and use of fossil fuels has immense implications. Many investors and investment fund managers are asking searching questions about companies’ performance against indices which measure responsiveness (or otherwise) to the climate crisis. It has also led to calls on major investors and organisations to withdraw investments altogether in companies engaged in fossil fuel extraction. In 2019, Synod passed a motion that the SEC should “update its ethical investment policy to reflect the moral imperative to divest from fossil fuels ...” and “to form an Ethical Investment Advisory Group to develop a strategy to enable divestment.”

[1] https://www.theguardian.com/money/2020/jun/13/ethical-investments-are-outperforming-traditional-funds
[2] https://www.morningstar.co.uk/uk/news/202274/investors-back-esg-in-the-crisis.aspx

Ethical Basis for Investment

Before one considers the practicalities of the SEC's investments, one needs to establish what is the basis of *ethical* investment and what are its implications in practice? Over the years, people have donated money to the SEC in the service of God, and the church carries the responsibility for the good stewardship of the money entrusted to it. This involves three foundational ethical principles of investment, which can be expressed as:

a) The responsibility of prudent use of the money entrusted to the church, in wise and effective investments, in the context of the economic situation prevailing at the time.[3]

b) The responsibility to make investments directly or indirectly in companies whose activities are not inconsistent with the church's spiritual and moral values under God, reflecting the most pressing needs of the times, and not to invest in those whose activities are contrary to those values.

c) The responsibility arising from the dependence of the missional work of the SEC upon the annual returns made from the investments for the work of the church, the staff it employs and the voluntary efforts of time, energy and talents of the wider church membership.

Taken together these three ethical principles form a basis for an ethical investment policy. It is clear that the second principle is meaningless unless it takes priority over the other two, in the event of a dilemma over a financially prudent and remunerative investment which does not line up with the church's ethical values. But this also raises a question of what then *are* the church's values, and how are these to be expressed in the context of investment choices.

Ethical Exclusions are not the full answer

The main response of churches has been that of making 'ethical exclusions' (see the Appendix). These are a list of specific activities, where a church has decided not to invest in a company whose main business is in these activities. In the case of SEC, these have been in armaments, gambling, pornography and tobacco, to which the 2017 Synod added the extraction of thermal coal or tar sands (see, in more detail, para 4(d) below). The advantage of this approach is that it should give those responsible for making the investments a wide degree of freedom to look for the best sustainable returns in the market place, provided care is taken to exclude investing in the specified activities. In practice, however, this approach to ethical investment runs into several significant problems:

1. In relation to a few activities like producing tobacco, it is fairly clear which companies should be avoided, but in many cases it is more complicated. A company may have some activities which the church would object to and also ones it would not wish to exclude as such. For example, should SEC's exclusions apply to all entertainment companies with *any* involvement in

[3] [This refers to the *ethical* principle behind the *legal* responsibility of 'fiduciary duty'.]

gambling? The current approach applies a numerical limit relative to a company's business, typically if 15% of its turnover is in excluded activities. In ethical terms, is this a reasonable response to the complexities of the real world, or is it an unethical compromise on what is a point of principle? Again, should we invest in a company which has now become a major promoter of renewable energies, while its core business remains in oil and gas extraction?

2. The notion of excluding certain activities from its investments assumes that the church is in a position to select directly the companies it invests in, and to monitor their activities as time goes by. If a small church like SEC considers that it cannot afford to do this (as more fully explored below), it must delegate the task to a third party fund manager, in which circumstances it may be much more difficult to insist on ethical exclusions.

3. Roughly two-thirds of SEC's investments are in pooled funds (see further section 4 below). Within a given pooled fund, SEC is one partner amongst many and cannot make exclusive demands that the fund avoid certain categories of investment. Thus, to the extent that the church uses pooled funds, the ethical exclusions become correspondingly inoperable, unless pooled funds can be found with filters that match the church's ethical exclusions. This is limited to the funds available in the market place at the time or to those offered by the current fund manager.

4. Ethical exclusion is a negative screen, not a positive filter. It does nothing to guide investors in doing good with the money, only not to do harm. *De facto* a negative screen makes the assumption that all other activities than the listed ones are equally good from an ethical standpoint and that their financial opportunity is the overriding value. This is ethically questionable.

Towards a wider Ethical Investment Strategy

This is not to say that ethical exclusions are a wrong approach, but to point out their limitations and that an ethical investment policy ideally needs to encompass much more than merely determining what to exclude. This is not a new question. The joint report to the 2013 Synod declared that " 'ethical considerations' must encompass much wider considerations [than exclusions]. Even a cursory reading of the Old Testament prophets show God's concern for the poor and his condemnation of dishonest and exploitative business practices. An investment policy reflecting a determination to live out a Christian ethic requires a broader application of 'ethical' considerations then a mere repudiation of certain investee companies." [4] We suggest an ethical investment strategy should ideally encompass also the following factors:

The first consideration is **positive investment**. The second of the basic ethical principles requires that an ethical investment policy should be a positive reflection of the values of the church, rather than a 'free-for-all with exclusions'. However, a wish list of 'good things we would like to do with our money' may not be realised in companies and funds with reliable and good returns. But SEC can draw upon the

[4] Church in Society Committee and Investment Committee report to General Synod 2013 "Ethical Investment and Ethical Banking"

experience and expertise of other churches and charities who have asked similar questions, through its membership of the CIG. It is suggested that SEC enters into ongoing discussion with relevant churches and religious charities on what they have been able to do in positive investment.

The second factor is to use our **influence by engagement**. The report to Synod of 2017 pointed out the potential of using our power as an investor to influence positively the activities of an organisation which we invest in. In ethical terms, this is to declare our ethical credentials not in standing morally apart, but in seeking to make improvements in a very imperfect real world, recognising that one is likely to ‘get one’s hands dirty’ in the process.

SEC should ideally be in a position to scrutinise the performance of companies we invest in, and if we have avenues and people able to do so, engage with them. The services of SEC’s fund manager include scrutiny and insight of companies’ performances. In engagement, SEC is in a position to draw on its membership of the CIG, which brings together the investors of all main UK churches and many Christian charities. The combined influence of many churches can be very effective. Methods include writing letters to companies, having meetings with senior executives, and filing shareholder resolutions, in all of which SEC can be a signatory, if it holds (preferably direct) investments in the company concerned.

For a relatively small church like SEC, it is arguably more important to seek to **influence the investment managers** to offer funds and to operate policies within them that meet our ethical values, and more broadly to promote and improve their ethical strategies. SEC should make a priority of taking advantage of the new opportunities in the investment market arising in response to the increasing demand for ethical investment and ESG factors.

Notwithstanding positive investment and engagement, **divestment** can also have a role in an ethical policy, in two ways. Divestment may be done as a matter of effectiveness. The argument for retaining an investment primarily in order to engage holds good only in so far as the church has a reasonable prospect of effective engagement. If its realistic ability to influence were small, and there were no prospects of collaborative initiatives, and there was no prospect that a company would change an objectionable policy, divestment would be the more ethical response. The Church of England indicated to certain companies with whom it had engaged that if there were not a marked improvement in their carbon reduction performance, they would divest.

Divestment may, alternatively, be done on a matter of principle. Even if it excludes the possibility of engagement with the companies concerned, the church may consider that a point of principle takes priority. The question is not effectiveness for change but being true to our values as a church. Which values are key and how these are expressed will vary with the situation. For example, this might be on a particular principle, or a matter of virtue ethics - what a wise and compassionate church would do in the relevant situation. For example, to hold investments in a company promoting tobacco would be to be complicit in the production and sale of an addictive and poisonous substance causing death and widespread damage to people’s health and their families. The exclusion by the 2017 Synod of extraction of thermal coal and tar sands applies the analogous principle towards companies actively promoting the extraction and use of primary causes of damaging climate change.

Fossil fuel company investments

The 2017 and earlier reports to Synod have laid down the moral imperative on all people and organisations to change their ways in order to limit the effects of climate change, which we and previous generations have set in train, and to limit future global warming to 1.5 degrees Celsius. This is the ethical foundation of the 2019 Synod resolution on the "moral imperative to divest from fossil fuels". But we need to clarify what is meant by the resolution. Put simply, one cannot divest from the raw chemicals, but from companies - but what sort of companies, engaged in what sort of activities?

In 2020, the SEC's last direct investment in a fossil fuel extraction company has been disposed of (see section 7 below), but this does not mean that SEC has now dealt with the fossil fuel investment issue. Divestment discussions have often lost sight of the fact that it is not the extraction of fossil fuel raw materials that is the primary cause of human-induced climate change, but burning them for heat, propulsion, or in chemical processes involving fossil fuel combustion. Investments in companies engaged in large scale *burning* of fossil fuels may now be more important than extraction companies. To exclude only fossil extraction while investing in such companies would be both scientifically and ethically inconsistent. The Synod motion has opened up a much more demanding exercise.

This, however, brings home that the use of our investments in addressing climate change is especially difficult and sensitive. This is because the burning of fossil fuels is utterly embedded in the both the lifestyle and the economy of our nation and all nations like us. Our very expectations have been framed around what we have been able to do with the apparently limitless availability of cheap fossil fuels. Until recently we have given little or no heed to the fact that the primary waste product released into the atmosphere by our actions was on such a scale that it would change the planet's chemical balance and physical systems. How to address this crisis with urgent speed, but without widespread disruption, is as difficult and urgent as limiting the spread of the Covid-19 virus. One unintended outcome of a near global lock-down has been to reduce emissions from transport. What should be the 'new normal' in respect of climate change, in our lives and activities as individuals, families, in our organisations and as a church, as much as in our investments, is a matter of the utmost seriousness and urgency.

Conclusions on an Ethical Investment Strategy

An ethical investment strategy for the SEC should ideally be multi-dimensional. It should involve positive investment, ethical exclusions, ethical engagement with companies and with fund managers, collaboration with the experience and initiatives of other churches, divestment in principle, and divestment because of failed conditions. All these dimensions of an ethical investment strategy may have their roles to play. Depending on each circumstance, one or another factor may take precedence. It should seek consistency, compassion and generosity and be prepared to go an extra mile for the kingdom of God.

Some have voiced concern that to move to a more ethically responsive approach to SEC's investments, rather than simply maximising our returns, would run the risk of reducing the amount of returns on investments and thus the amount of money available for the church's missional and central activities. This is an important concern and needs to be borne in mind, especially given the terms of the EIAG's remit noted at section 2 above.

Is it indeed the case that returns would necessarily be reduced? The Morningstar report on the good performance in 2020 of ESG-oriented funds compared with traditional funds may challenge that assertion. However, whilst it is acknowledged that there are ethical pooled funds that provide good returns, some do not, and not all would be suitable for the UTP as there are other investment criteria to be considered. EIAG's initial review of ethical pooled funds (see para 8(d) below) identified a relatively small number of funds that might meet the UTP's investment criteria from the much wider choice of funds currently available. Therefore, although one still has to be careful in choosing an appropriate ESG fund, it is not axiomatic today that ethical investment means lower returns. Secondly, what would be the ethical basis for contending that for SEC to do its investments ethically is not important if the result would mean, for example, losing our local priest, or the closing of a department at the church offices? Such real world questions as these prompt us to ask, as followers of Jesus Christ, what ethical values matter most? These are not easy questions to answer.

At the time of Wilberforce, the abolition campaign alerted many people to the fact that a significant part of Britain's prosperity at the end of the 18th century was derived directly or indirectly from the slave trade. The economic disruption that abolition would cause was a major argument used to defeat successive abolition bills in Parliament and prolonged the slave trade for many years. If people have belatedly awoken to the fact that our present lifestyles are won and enjoyed at the cost of climate change, the church cannot say 'business as usual'.

4. Context – the UTP and its place in the funding arrangements of the SEC and in the investment marketplace

(a) The UTP is a pooled fund in which investments for many parts of the SEC are managed so as to generate a reliable return to fund various aspects of the SEC's regular work. Those investments are held in trust and must be managed in accordance with the relevant fiduciary duties. The investors in the fund include the General Synod (approximately two thirds) and various dioceses and also about 190 individual congregations (the remainder). The objective of the fund is to generate a stream of income (distributed six monthly) increasing in line with inflation without eroding the value of the underlying fund, while avoiding excess volatility. The UTP is worth approximately £99.5m and over the last year produced a net income for its investors of £2.3m. This income is of critical importance to the SEC's mission in, for example, paying for the central administrative machinery of the SEC and various centrally-orchestrated SEC programmes, such as training candidates for ministry, the annual youth camp, safeguarding, supporting retired clergy and providing grants to dioceses and charges to assist in meeting a range of costs including those related to mission, ministry and maintaining and developing buildings. The UTP typically provides around 60% of the income required for such things. In the absence of that income, it is likely that reserves would quickly be depleted and other sources of income would have to be found, for example by increasing congregational contributions significantly by way of quota or securing additional donations from individual church members, failing which cuts would have to be made to the work of the church in various respects.

(b) The management of the UTP is in the hands of professional managers appointed by the SEC Investment Committee, who report via the Administration Board to the Standing Committee. The managers are tasked to invest so as to preserve the value of the UTP while maintaining the real value of the income received from it, for the benefit of SEC investors, in accordance with the above objective. Optimising returns usually involves taking a degree of investment risk which must be balanced against the need not to hazard the funds in the UTP. Thus the investment decisions which have to be taken involve delicate questions of balancing perceived risk and reward.

(c) In recent times, the professional managers appointed by the Investment Committee have been Baillie Gifford. The Investment Committee consider that they have provided a good service for a competitive fee.

(d) The UTP is currently divided into three very roughly equal sub-funds. One of these sub-funds (the Global Income Growth Portfolio) is directly invested into specific, individual holdings, in accordance with a set investment strategy implemented by Baillie Gifford for a number of their clients. There are existing SEC exclusionary rules applied in relation to this fund (companies with in excess of 15% of their revenue derived from tobacco, armaments and gambling have been excluded since 1998; companies with in excess of 15% of their revenue derived from pornography have been excluded since 2013; and companies deriving over 10% of their revenue from the extraction of thermal coal or tar sands have been excluded since 2017). Baillie Gifford have been advised in 2020 that no further investment of SEC monies in this fund should be made into companies involved in the extraction of fossil fuels. The other two sub-funds are invested in funds run for more general investment purposes by Baillie Gifford (the Multi-Asset Income Fund and the Long Term Global Growth Fund). Investing in such pre-existing funds reduces the level of charges that Baillie Gifford would otherwise have to levy for the management of the UTP, as well as increasing diversification and therefore reducing volatility. No SEC ethical filters are currently applied to either of these pooled funds, although Baillie Gifford apply their own filters and protocols to such funds.

(e) Despite what may seem at first sight to be the significant overall value of the UTP, in investment terms the UTP is a small fund. If bespoke investment arrangements are made for funds, particularly small funds, there is a high risk that the management charges will rise as a proportion of the income generated by the fund, thus reducing the sums available to the investors as income.

5. Context – the high level of dependence of the centralised work of the SEC on the UTP

(a) In comparison with other UK church bodies, the SEC is unusually reliant for funding of its day-to-day operations on the income generated from the UTP. As mentioned above, about 60% of the income of the SEC is derived from its investments as against an average of around 10% in Anglican dioceses in England and Wales (ignoring such income as these dioceses may receive from the central funds held by the Church Commissioners). A study of annual accounts of 44 English and Welsh Dioceses (using Charities Commission data) indicates that on average investment income from their own investments is less than 10% of their total income, as indicated in the following table, and even the most dependent upon investment income obtains only 27.5% from that source:

	Total income (m)	Income own investments (m)	Income own investments (%)
Total dioceses	541.2	49.76	
Average	12.1	1.13	9.19%
Diocese with lowest absolute income	3.5	0.09	2.60%
Highest absolute income	27.1	2.37	8.70%
Least dependent on own investments (% relative terms)	10.6	0.12	1.10%
Most dependent on own investments (% relative terms)	10.6	2.92	27.50%

(b) Of the national church organisations, only the Representative Body of the Church in Wales has a higher level of dependence on income from investments (around 95%) with USPG and the Jesuits around 40%. An investment strategy has to be appropriate to the income requirements of the organisation, and managing volatility and risk becomes increasingly important with an organisation's dependence on investment income. These factors will have to be borne in mind in establishing ethical investment policies for the SEC.

6. Context – the current investment environment

(a) The EIAG duly notes the exceptionally challenging environment for investment and for the economy generally at the time of writing, following the development of the crisis revolving around the Covid-19 coronavirus. The EIAG nonetheless looks to present this paper looking at the issues as ones of principle, with suggested solutions that should be applicable in most market conditions.

(b) What the present crisis does illustrate very clearly is the way in which sudden and unexpected changes of market conditions can make the task of maintaining the value of the UTP and producing the income that various parts of the SEC rely upon from the UTP very challenging. This emphasises the importance of applying competent investment strategies for the UTP, and particularly of adequate diversification across many spheres of commerce, in the hope that, even if one or more sectors of the economy are struggling at a particular time, others will outperform so as to even out overall returns – the importance of "spreading one's eggs between many baskets".

(c) The EIAG also acknowledges that the relevant investment environment is in any event a rapidly-changing one, with a greater emphasis on environmental and social issues. Human-induced climate change and the imperative to reduce fossil fuel extraction and consumption have become mainstream issues across all sectors of the economy since the UN Framework Convention on Climate Change was agreed by the world's governments in Paris in 2015. This has led those involved in the investment industry to recalibrate their expectations and advice in relation to companies involved in fossil fuel extraction, with a new-found concern that such companies may, at some stage, be barred from further extraction (at least in some locations, or by using some technologies), or be otherwise penalised by governments. Therefore holdings in such companies tend to take a much lower profile in standard portfolios than they once did. There is also an increasing appreciation in the investment industry that investors, both private and institutional, may wish to avoid investment in companies that are involved in fossil fuel extraction for ethical reasons, and therefore an increasing range of funds are being established which avoid such companies, to meet this demand (as touched upon above in section 3). Further, indices of companies have begun to be published ranking them in terms of the carbon neutrality of their business, or according to other ethically-focussed criteria (e.g. the Responsibility 100 Index and the TPI Climate Transition Index).

(d) The investment environment, both generally and specifically, is therefore very dynamic and the guidance which the group will propose needs to be sufficiently flexible to allow sensible investment decisions to be taken by the Investment Committee in a fast-changing environment, with the advice of their professional investment managers.

7. Proposals for a definition of 'full divestment from fossil fuels' for the purposes of the UTP.

In line with the growing understanding of the climate crisis and the need for restriction of fossil fuel extraction mentioned above, the motion passed by GS 2019 stipulated that the UTP should "divest fully from fossil fuels". A difficulty arises of knowing what precisely that is to mean for the instruction of the managers of the UTP. It seems that there is no generally-accepted definition of this term, even amongst those who favour ethical investment.

(a) The EIAG proceeds on the basis that "fossil fuels" means oil, coal and gas and related carbon-based materials in the ground which are commonly extracted and used as fuel. However, fossil fuels are also extracted for a wide variety of other uses, such as raw materials for plastics, clothing, household products, etc. EIAG understands the motion is directed to extraction for burning as fuels, in the first instance.

(b) As pointed out in section 3 above, this opens up a wider discussion of investment in companies involved in the large-scale burning of fossil fuels, and the EIAG would propose to look at other aspects of fossil fuel divestment at a later stage.

(c) In addition to companies whose core business is the extraction of fossil fuels, some companies may have interests in fossil fuel extraction that form a small, part of their business. For that reason, it is conventional to set a percentage of turnover which is to be taken as being a less than peripheral involvement in the industry. The figure we propose is 10% of turnover, as applied already in relation to thermal coal and tar sands.

(d) One possible approach thereafter is to require that all direct, individual investments currently held in the UTP in companies that generate more than 10% of their turnover from extracting fossil fuels from the ground should be sold, and that no further direct, individual investments should be made in such companies. We asked for clarification from the managers of the UTP as to what this would involve, practically. They reported that as at 31st December 2019 the value in the UTP so directly invested was £92,715.72, being a holding in Total, a fossil fuel extraction company. That represented 0.35% of the directly-invested funds in the UTP, under the relevant Baillie Gifford strategy. Baillie Gifford have since sold the holding of Total in this fund and SEC accordingly is understood currently to have no direct investments in companies engaged in fossil fuel extraction. As mentioned above, Baillie Gifford have been advised that no further direct investment of SEC monies should be made into such companies.

(e) Another possible approach is to require that all such investments, whether held directly or indirectly (i.e. as part of a pooled fund) should be sold, and no further investments should be made in such companies or into funds that hold investments in such companies. We asked for clarification from the fund managers as to what proportion of the entire UTP is so held. Of the whole of the UTP as at 31st December 2019, including the pooled funds mentioned above, a total of about £311,846.49, being 0.36% of the funds, was held in such companies. Within that amount, the companies in question were for the most part involved in fossil fuels, with smaller contributions from tobacco and gambling. While the directly-invested holding in Total just mentioned was disposed of relatively easily, Baillie Gifford could not be compelled by SEC to divest the relative investments in the two pooled funds.

(f) The EIAG notes that in divesting from all companies in the fossil fuel sector wholesale, one would also be divesting from some of the leading investors in renewable ("green") energy generation. For example, Shell is engaged in very significant extraction of fossil fuels, but is also currently one of the world's largest investors in the development of renewable sources of energy. Nonetheless, as the GS motion focused on divestment rather than positive (or "impact") investment, we have not considered that issue further at this stage.

(g) It would be possible to take the understanding of "divestment from fossil fuels" to an extreme which would be likely to make stockmarket investment unfeasible, because such a broad range of companies would be excluded from consideration that the necessary diversity could not be achieved in the UTP portfolio (leading to unacceptable levels of investment risk). For example, it could be understood also to require divestment from all sectors that made major use of fossil fuels – such as road transport, aviation, construction, shipping and conventional energy generation. Even more extremely, it could be taken to exclude any company which made any use of fossil fuels whatsoever, thus cutting out any company which used fossil fuel-powered transport to any extent at all, or used any plastics derived from fossil fuels, or played any part whatsoever in the industries that extract fossil fuels (for example, by manufacturing parts or providing outsourced recruitment services). This would involve unfeasible levels of due diligence to analyse and monitor the detailed business of each potential investment and in any event would leave very little of the market available for investment. It is the view of the EIAG that such extreme understandings of "divestment from fossil fuels" cannot have been what the General Synod had in mind in 2019. However, as noted above, the EIAG will proceed in due course to examine the broader questions in relation to fossil fuel use discussed in section 3.

(h) The EIAG therefore proposes a definition of "divestment from fossil fuels" for present purposes as follows: "Divestment from fossil fuels means the avoidance of any investment which results in the UTP holding, directly or as part of a pooled fund, any interest in any business which generates more than 10% of its turnover directly from extracting fossil fuels." This would therefore be proposed as an additional "red line" which would apply to investment on the part of the UTP in any individual holding or pooled fund for the future.

8. Recommendations on the use of pooled funds in the UTP

(a) The EIAG appreciates the benefits which investment in pooled funds brings to the UTP. By investing in such pooled funds, one obtains (i) significant diversification (and therefore, in principle, increased resilience against economic shocks) and (ii) reduced management charges compared to what one would have to pay to achieve a similar level of management attention and diversification of investments by making direct investments. Therefore the group does not, as a matter of principle, rule out the use of pooled funds for the UTP, and indeed accepts their positive contribution to sound investment management.

(b) However, given the passing of the GS resolution in June 2019 and the suggested definition set out above, it will now be necessary for any pooled fund selected to adhere to the above definition of "divestment from fossil fuels". Following the motion, any such pooled fund should also in principle adhere to the other "red lines" already fixed in relation to direct investment for the UTP – namely, to avoid investment in companies with in excess of 15% or their revenue derived from tobacco, armaments, gambling and pornography and companies deriving 10% of their revenue from thermal coal or tar sands. See section 9 below in relation to the practicalities of this proposed divestment in relation to pooled funds.

(c) As suggested above, whereas in the past it might have been very difficult to find existing pooled funds which would match these red lines, that situation is rapidly changing. There is a broad interest in the concept of ethical investment, driven not only by charities and religious bodies but also by mainstream investors (such as pension schemes, councils or universities) wishing to impose ethical limitations on what their funds are invested in. The varied approaches taken to ethical investment by some other bodies, including in particular churches, are highlighted in the Appendix.

(d) It is now possible to identify a growing number of pooled funds where ethical screens are applied as a matter of course. The screens applied tend to overlap with, but occasionally include and go further than, the screens so far chosen by SEC. Such funds include:

- Epworth (funds managed for the Central Finance Board of the Methodist Church) – would apply ethical screens that include, and go further than, the proposed SEC exclusionary categories.
- CCLA Investment Management COIF Charities Ethical Investment Fund – a multi-asset fund that would apply ethical screens that include, and go further than, the proposed SEC exclusionary categories.
- BMO Global Asset Management responsible funds – BMO offers a range of funds with exclusions that would match the proposed criteria
- Northern Trust Green Transition Index Fund – a passive fund that fully divests from companies with fossil fuel reserves, excludes the

top 10% of carbon-intensive companies and screens out businesses involved in weapons and tobacco, amongst other things.

- Mercer/LGIM Passive Sustainable Global Equities – a passive fund that excludes companies with significant income from pornography, alcohol, gambling, tobacco, "controversial" armaments and fossil fuels.
- RBC Vision Global Horizon Fund – an active fund that excludes, amongst others, alcohol, tobacco, adult entertainment, gambling, weapons or extracting, processing or transporting coal, oil or natural gas.

In addition, certain fund managers would be prepared to screen a portfolio of direct investments for a client:

- Rathbone Greenbank – can offer a screening service for charity clients.
- Ruffer – can provide screening to a client's specification in a segregated portfolio.

As with all other matters reviewed in this paper, this is a fast-evolving situation and it seems highly likely that further ethical funds which will meet the proposed SEC exclusionary criteria will become available, including (potentially) funds managed by BlackRock, Baillie Gifford and others. Baillie Gifford are understood to be working on devising an ethical multi-asset fund that would exclude tobacco, alcohol, armaments, pornography and fossil fuels. They also have a Responsible Global Equity Income Fund and a Global Alpha Choice Fund that may meet the SEC's proposed ethical criteria.

Selection of funds would remain a matter for the Investment Committee, against the background of the SEC's ethical and investment criteria.

9. A proposed timescale for the implementation of changes to the UTP

The EIAG accepts that to make changes of this nature to the management of a fund such as the UTP must be carefully managed and will take time. There will be costs involved in any sales and purchases of holdings required. There may conceivably be a necessity to find an alternative investment manager for the portfolio, depending upon the charges that various managers might propose for managing the portfolio with these additional red lines in place for pooled funds as well as direct holdings. In the meantime, there is currently a very small portion of the overall portfolio of the UTP (about one third of one percent) invested in excluded businesses. The group suggests that the Standing Committee should be instructed to communicate the newly-updated ethical guidelines to the Investment Committee. Thereafter, the EIAG is to consider what other guidance should be given in relation to other "unethical sources of revenue", including other fossil fuel-related activities. The EIAG proposes that rather than start to impose the red lines on all pooled investments when those red lines may change in relatively early course, the appropriate way to proceed would be to hold over the application of the red lines to pooled funds until after GS 2021, by which time it is hoped that the EIAG's additional guidance should be available.

10. Footnotes

(a) The EIAG appreciates the strength of feeling in relation to fossil fuel divestment which led to the passing of the motion at GS 2019. The vote at GS 2019 will require the introduction of the new "red line" and its eventual application to not only direct investments but also pooled investments. This will have, to an extent, an impact on the ability of the Investment Committee and their professional managers to manage the UTP so as to achieve its objective, outlined above.

(b) The EIAG would caution that GS should not rush to introduce other red lines into the picture without very careful consideration. It is possible to think of various other red lines which could be introduced, which might prove more or less controversial amongst the broader membership of the SEC. The more such red lines are introduced, the harder it will be, even in the modern environment, to keep within them whilst also not adversely impacting on income levels, diversification and the level of charges which the UTP will have to pay to secure professional management of its investments.

(c) Nonetheless, the EIAG will proceed to examine the remaining aspects of its remit, including that of seeking to reach a general definition of "unethical sources of revenue" which may be applied for the future when assessing whether or not other red lines might be desirable. It will also, in a more positive approach, consider whether and, if so, how the UTP might consider impact investment – the selection of investments on the basis of a positive bias in favour of businesses and funds seeking to demonstrate particularly good and responsible management and/or to make the world a better place.

Alan McLean QC
Chair
On behalf of the Ethical Investment Advisory Group
3 September 2020