

## **ETHICAL INVESTMENT ADVISORY GROUP**

### **REPORT TO GENERAL SYNOD, JUNE 2022**

#### **1. Background**

**1.1** Following the establishment of the SEC's Ethical Investment Advisory Group ("EIAG") after General Synod 2019, its Interim Report to General Synod in 2020 and the approval of the Policy Framework for Investment of SEC Unit Trust Pool ("UTP") Monies in Pooled Funds by General Synod 2021, the EIAG has continued its work to fulfil the initial remit given to it by Standing Committee. The remaining matters requiring to be addressed are:

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

**1.2** The background to ethical investment of the UTP remains highly complex. Several factors need to be borne in mind together.

Compared with many denominations, the SEC is unusual in its high level of dependence on the return it derives from the UTP in fulfilling its on-going missional activities. This results in an acute need to preserve the capital and to maintain a high level of return to support the work of the Church. For a church seeking to manage its affairs consistently with Christian ethical values, however, it is not acceptable simply to maximise the financial return, without regard for the activities of organisations in which its moneys are invested. There are the many potential ethical issues that are faced today by any investor seeking to do good with their money and to avoid doing ill with it. As well as sectors over which there are long established ethical objections, new areas of concern are regularly raised, which may be thought to require varying types of response. The interim report to the 2020 Synod laid out a range of responses, of which, for example, divestment is only one,

Further, there is the very fast-changing picture as regards environmental, social and governance ("ESG"), sustainable and other ethical investment criteria. In the investment marketplace, concerns about such matters are no longer the minority interest that they perhaps once were, but are now mainstream factors for investors to take into account. There are now multi-billion pound industries involved, with more and more providers offering ethical screens for investment and/or ethical funds in which to invest, with multiple sources of rankings of investments on varying bases widely available. Notwithstanding this expansion in interest in ethical investment, it is not at all straightforward to find funds, investment strategies and fund managers which will be an exact match for what SEC requires both ethically and in terms of other investment requirements.

Lastly, it also has to be borne in mind that the UTP funds are relatively small, both in terms of the general investment industry and also compared with funds invested by various other Christian denominations. The SEC does not have the resources to devote time and expenditure to, for example, engaging with companies in order to

influence corporate behaviour, as some larger churches can. To have such influence, SEC must rely on its membership of larger bodies of church investors.

**1.3** This background was explored in some detail in the EIAG's Interim Report of 2020, to which readers are referred. The picture has continued to evolve at a rapid pace since that report was written. Notwithstanding these and other difficult and constantly changing issues, the SEC needs a sound framework to permit it to address the issue of ethical investment in the longer term.

**1.4** The challenge for the EIAG to fulfil its initial remit has been summarised as one to propose a robust, and yet sufficiently flexible, set of (a) principles and (b) procedures by which the UTP, under the expert care of the SEC's Investment Committee and its appointed professional investment managers, might navigate these difficult waters for the foreseeable future.

## **2. Principles - 'unethical sources of revenue'**

**2.1** EIAG's Interim Report, para 3, sets out some broad principles that the EIAG found important to bear in mind when examining what is meant by "ethical investment" for the SEC. Readers are referred to that material for significant background considerations that have influenced our discussions throughout.

**2.2** SEC (through General Synod) has taken decisions that certain sources of income are unethical for the UTP, and has put in place exclusionary "restricted categories" that reflect those decisions. Those restricted categories have then been applied by the Investment Committee to investments held directly (i.e. as individual holdings) within the UTP. The restricted categories are as follows:

Companies deriving more than 15% of their revenue from tobacco, armaments and gambling (excluded by decision of General Synod 1998);

Companies deriving more than 15% of their revenue from pornography (2013);  
and

Companies deriving more than 10% of their revenue from extraction of thermal tar and coal sands (2017).

Since General Synod 2019, although this has not been formally adopted by Synod, the Investment Committee and the managers of the UTP have also applied a rule against investing in companies deriving more than 10% of their revenue from extracting fossil fuels by any means. This subsumes the rule against investing in companies deriving income from extraction of thermal tar and coal sands. There is an argument that in each of the above cases, it might be more straightforward if the percentage figure were set at 10% for the future. We are advised by SEC's current investment managers that this would cause them no difficulty and we accordingly recommend that that change is made, and that the rule in relation to extraction of fossil fuels is formally adopted.

**2.3** However, these restrictions do not easily apply to the parts of the UTP which are in pooled funds, over which SEC, as one investor in the pool amongst many, does not have exclusive power to stipulate exclusions. After General Synod 2021 adopted the EIAG's proposed Policy Framework, these restricted categories have also been applied to pooled funds within the UTP, by way of the procedures established under

that Framework. At the time of the Investment Committee's first annual report under the Policy Framework, focussing on the position as at 30 September 2021, the UTP was fully compliant with the Policy Framework.

**2.4** EIAG is now tasked with proposing a general definition of "unethical sources of revenue" for the UTP. The challenge in this regard is that, in order to stand the test of time, such a definition needs to be framed broadly, and needs also to take into account the fact that on many issues related to ethical investment, different members and groups of members within the SEC might quite legitimately disagree, notwithstanding their shared theological starting points. Simply by way of example, in a number of other denominational settings, to derive any income at all from the production or sale of alcoholic drinks would be unconscionable. It is understood that in the SEC there would not be unanimity on that issue.

**2.5** We have considered a number of different approaches to defining ethical investment utilised not only by other Christian bodies that have significant investments, but also within the wider investment industry, where, as mentioned above, there is currently considerable activity in the constructing and marketing of "ethical" investment funds. Every major investment manager claims to give a role to ethical and/or ESG and/or sustainable investment principles.

What has become clear to us is that there is absolutely no standard definition of "ethical" or "unethical" sources of revenue. Indeed, the many league tables that are published ranking companies according to ethical criteria are capable of disagreeing profoundly as to whether investing in any particular company is or is not "ethical", depending largely on the criteria that the authors take into account when compiling their tables and also the weighting given to those criteria. A company like Tesla, for example, can feature above or below Exxon Mobil in such tables depending on the approach of those compiling the table. Funds marketed as "ethical" can be found to have large holdings that some people, now or in the past, might have considered to be potentially ethically questionable, in (e.g.) oil companies, "big pharma", brewers/distillers, large banks, mining companies, and/or companies sometimes suggested to underpay or otherwise mistreat their employees.

One broad approach to such matters might be to ask whether, if the company in question doubled in size over the next five years, that would be good or bad for the planet. The answer to such a broad question would nonetheless be open to different answers depending on what one meant by "good" and "bad", and how one balanced outcomes that might in part be bad and in part good. In the setting of a Christian body, one would want to factor in to such an approach also whether such an expansion would be good or bad for humanity and indeed for the gospel. Further complexities arise when one considers how to apply such criteria to investment not in companies but in government debt, whether of the UK or other countries, another highly topical issue in the ethical investment sphere. There are complexities too in assessing the trajectory of entities, in terms of whether they are at any given time moving towards or further away from the ESG approach that is felt to be most desirable.

**2.6** Following lengthy discussion and consideration, our proposal for broad criteria to guide the assessment of what may or may not be an ethical source of revenue for the UTP is as follows:

Does the entity in question tend to promote (or, conversely, to harm):

- a) the health and dignity of human beings, particularly the most disadvantaged in society;
- b) the long-term stewardship of the planet; and
- c) the mission of the worldwide church?

It is hoped that the theological underpinning of the three aspects of this approach is uncontroversial ((a) love and respect for all our neighbours, made in God's image, particularly the poor; (b) love and respect for God's creation, entrusted to us; and (c) the Great Commission and the call to serve others).

**2.7** The aim is not that the SEC should use these broad criteria or any one of them to impose more *de facto* restricted categories – but rather to influence discussions within the SEC with a view to maximising these things, not only by avoiding harmful investment but also seeking out investments that will positively promote desirable outcomes – i.e. “impact investment”.

### **3. Procedure - a framework for considering and implementing investment criteria, to include restrictions and impact investment.**

**3.1** By the time of the Interim Report in 2020, EIAG had reached the view that “ethical exclusions”, were not the full answer to ethical investing. We cautioned in that report against rushing to delineate new areas from which simply to divest. Following further consideration, EIAG has reached the general view that simple ethical exclusions are seldom the answer in the complexity of the issues and the organisations, in relation to modern slavery, for example. We have to consider each area on its merits. The full practical (as well as ethical) consequences need to be carefully considered and weighed before any proposal is put before General Synod.

**3.2** Nonetheless, there will undoubtedly continue to be issues that arise that require SEC to consider the ethics of how the UTP is invested. As a Christian body, SEC cannot abdicate its responsibility to think about these things, as matters of integrity and faithfulness to the churches' prophetic role.

**3.3** It is simply not possible to predict what all these issues might be. The whole area of fossil fuel extraction gives a very good and clear example of how something can change from being an accepted part of everyday life, and indeed a core element of any responsibly-invested fund, to being something that is known to be the major cause of the climate crisis, and thus ripe for exclusion. Fossil fuels also provide a good example of the complexities that are faced as soon as one begins to reflect on all aspects of such an issue – in the age of the Covid-19 pandemic, we cannot manage at this point in time without significant amounts of single-use plastics, derived from oil, for example for PPE and lateral flow tests; and, further, it perhaps turns out that the primary targets of concern should not be those who *extract* fossil fuels so much as those who *burn* them – which in the modern economy means many, many different entities, including the SEC and most of its members. We also acknowledge the ethical dilemma that some of the largest fossil fuel extractors are now attempting to become major players in the transition to green energy. It is difficult, for example, to decide whether one insists that none of a company's income should come from extracting fossil fuels before one invests, or alternatively permits some small percentage of such income. It is also complex to know how one addresses the issue of trends in a company's performance in that regard. These

issues must nonetheless be carefully considered, and the product of that consideration fed into the decision-making processes for the UTP investments.

**3.4** We have therefore reached the view that, for the future, SEC needs a mechanism whereby both ethical concerns about investments and ideas for investments which aim to make a positive ethical impact can be addressed and evaluated. This should provide input for the Investment Committee to bear in mind, in conjunction with its professional investment managers, on an on-going basis. This will require a standing group within the SEC with the personnel having the appropriate experience and skills, and (if necessary) the budget, to be able to deal effectively with such matters. We are conscious that the initial remit of the EIAG will shortly be completed. We would suggest that either the EIAG should be re-tasked by Standing Committee to undertake this role, or alternatively the EIAG should be disbanded and Standing Committee should be required to set up a replacement group, under whatever title is thought appropriate, to deal with such matters.

**3.5** It is vitally important that such a group is properly equipped in all respects to deal with the issues that it has to address. The EIAG has benefitted enormously from having members, all drawn from within the SEC, who bring advanced expertise from the world of finance and investment (including some members of the Investment Committee) and from the world of ethics and theology (including some members of the Church in Society Committee and members of the Clergy) – and indeed some who are equally expert in both worlds. It may be thought to be helpful to have a chair who comes from none of these worlds, but rather plays the role of making sure that all voices are fully heard and properly taken into account.

**3.6** As for the mechanism, we feel that an appropriate way forward should be as follows. Such a group should have an on-going remit to be looking out for, investigating and reporting to Standing Committee on such ethical issues. Further, should a member of the church have any concern about the ethical quality of one or more of the holdings in the UTP, or a concern about whether the UTP should or should not be focussed on any particular area of investment, then that concern should be directed to the proposed group. That group would then be responsible for liaising with the Investment Committee and, where relevant, the Church in Society Committee on the issue and investigating and assessing that concern as against the ethical principles outlined above and in the wider setting of ethical investment approaches then current and the practical realities and consequences of various possible courses of action, and to report on that to Standing Committee.

It is possible that such investigation may require the obtaining of external research input, and for that purpose it may be necessary for the group to have a budget allocated to it – the SEC does not have enough resources (in contrast, for example, to the Church of England, with its vastly larger endowments) to generate such research in-house.

The group's report to Standing Committee could suggest one or more of a range of responses – for example,

- it could suggest that the concern should be noted and highlighted to the Investment Committee, to be given particular weight in its deliberations and discussions with its investment managers;
- it could suggest that nothing more need be done about a particular issue;

- it could suggest that it was desirable for impact investment to be focussed in a particular area;
- or, it could recommend that the Investment Committee engage with its investment managers to seek to influence the composition of funds invested in, to change those funds, or to seek to influence corporate behaviour by a particular company.

It would then be for Standing Committee, as the charity trustees responsible for the UTP, to consider what action to take in light of that report – which may or may not include an instruction to the Investment Committee or a motion being put forward to General Synod to give effect to the group’s recommendation.

**3.7** The EIAG accordingly recommends the above framework for considering and implementing ethical investment criteria, in light of the proposed principles.

**3.8** Purely as an aid to further discussion, we have appended to this report a draft for the possible remit of such a group. Such a remit would need to be agreed and issued by Standing Committee. We also append a proposed Ethical Investment Policy Statement for the SEC Unit Trust Pool for consideration at General Synod 2022, which, among other things, updates the exclusionary policies as suggested at para 2.2 above.

**Alan McLean QC**

**Chair**

**Ethical Investment Advisory Group**

**June 2022**

**Appendix:**

Draft terms of reference/

**The Scottish Episcopal Church**

**[insert name of group]**

**Terms of Reference**

**Name:** [insert name of group], hereinafter referred to as the Group.

**Type:** The Group is an advisory group convened by the Standing Committee of the SEC to support the work of the Investment Committee (IC) in managing the SEC’s Unit Trust Pool (UTP). The Group has no remit in respect of the SEC Pension Fund.

**Purpose:** The Group’s purpose is to support the IC to invest in an ethical manner that aligns with SEC’s Christian beliefs and investment objectives. This will be achieved by offering timely and practical advice on issues such as public policy

issues and ethical screening criteria. Such advice shall be grounded in Christian theology. The advice will be offered by the Group to Standing Committee, as the charity trustees of the General Synod, for consideration and passing on (as appropriate) to the IC.

**Authority:** The Group shall have no investment powers and may act only in an advisory capacity in accordance with its purpose as described above. Advice given by the Group shall not be binding on Standing Committee or the IC.

Nothing herein shall oblige the Group to give advice the nature and circumstances of which would require the Group or any member to obtain a Part 4A permission under the Financial Services and Markets Act 2000. The advice and other activities of the Group are not, and are not to be construed as, financial or investment advice.

With prior approval of Standing Committee, particularly in relation to any expenditure involved, the Group may make arrangements with third parties for such matters as the Group thinks necessary or desirable in connection with the fulfilment of its purpose, for example by engaging independent, technical or professional expert advisors, or commissioning research or theological analysis.

**Accountability:** The Group shall be accountable to Standing Committee. It shall have regard to (but shall not be bound by) opinion expressed in General Synod and shall publish an Annual Report of its activities and lay it before the General Synod.

**Feedback:** In relation to each report by the Group to Standing Committee, Standing Committee will provide a written response to the Group explaining the action that has been taken in light of that report, or, if no such action has been taken, explaining why that is so.

**Membership:** The Group shall have a total membership of at least seven and no more than ten persons, appointed by Standing Committee. At least two members shall be drawn from the members of the IC and at least two members shall be drawn from the members of the Church in Society Committee (CISC). At least two members of the Group shall be members of the clergy, of whom ideally one will be a Bishop.

Standing Committee shall select a Convener who is neither a member of the IC nor of the CISC.

Overall in selecting the members, Standing Committee will ensure that there is an appropriate balance of expertise, independence of thought and diversity among members. Relevant skills and experience might include, but are not limited to, the fields of investment, finance, business, theology, ethics, missional activity and public policy.

The Convener shall seek the advice and support of the SEC Secretariat for any communications relating to the Group, having also consulted with the Standing Committee in relation to any such communication.

The SEC Secretariat will provide general administrative support to the Group.

**Terms of Office:** Members shall be appointed for a term of four years, and may be re-appointed for a further term of four years.

**Meetings of the Group:** The Group will decide on the frequency of its meetings, and will meet at least once per annum. Such meetings may be held in person or remotely by electronic communication. The group will work collaboratively in consultation with IC, CISC and other groups within the SEC having an interest in the field of ethical investment.

The Group's agenda:

- will include matters recommended and requested by Standing Committee for discussion.
- will include additional items determined by the Convener on behalf of the members of the Group, IC, CISC, or in response to events/current affairs or concerns highlighted by one or more members of the SEC.
- will, on an on-going basis, include an element of 'horizon scanning'.

**Minutes:** Meetings will be minuted. A draft copy of the minutes will be circulated to all Group members as soon as practicable after the meeting. At the next meeting of the Group the minutes of the previous meeting will be considered and, once agreed to be accurate, will be adopted as a record of the previous meeting.

**Quorum:** The quorum for meetings of the Group shall be one third (rounded to the nearest whole number) of the members of the Group, provided that the Convener and at least one member drawn from each of the IC and the CISC are present.