GENERAL SYNOD

DIOCESAN SYNOD MOTION: ENVIRONMENTAL ISSUES

Background note from the Ethical Investment Advisory Group

The Ethical Investment Advisory Group (EIAG) and the National Investing Bodies (NIBs)

1. The EIAG advises the three CofE NIBs (the Church Commissioners, the Church of England Pensions Board and the CBF Church of England Funds) on ethical investment policy. Members are appointed by the NIBs, General Synod, the MPA Council and the Archbishops' Council. Responsibility for managing C of E investments rests solely with the NIBs.

2. The NIBs have long recognised climate change as an ethical investment issue. The policy the NIBs adopted in 2008 is reproduced as an Annex to this paper, under which they commit to:
    - integrate climate change considerations into their investment practice, taking account of both risks and opportunities;
    - support initiatives to help reduce the threat and impact of climate change;
    - engage with companies about their response to climate change; and
    - explore ways of measuring the carbon footprint of their investment portfolios.

3. The policy is implemented by the NIBs and EIAG Secretariat working in partnership. Some examples of how are given below.

Integrating climate change considerations into investment practice

- Before selecting an investment manager, the NIBs consider the extent to which the manager integrates environmental, social and governance ('ESG') factors into investment decisions.
- The Church Commissioners have a specialist sustainable investment mandate with Generation Investment Management (~£203m at end 2012, representing just over 10% of the Commissioners' investments in shares) and are one of the largest investors in an environmental technology fund, Impax Environmental Markets (~£11m at end 2012).
- The Commissioners also have significant investments in sustainable forestry in the UK and overseas (~£96m at end 2012). The forestry programme should constitute 4% of their total investment portfolio by 2015, subject to the sourcing of suitable investment opportunities.
- The Pensions Board has allocated funds for infrastructure investments, a substantive proportion of which the Board expects to be invested in renewable energy infrastructure.
- The multi-asset CBF Church of England Investment Fund has over 2% of its assets in renewable energy infrastructure and timber. It also does not invest in companies where FTSE's ESG Ratings indicate little evidence of high climate change risks being mitigated
- Both the Church Commissioners and the CBF Church of England funds have measured the carbon emissions associated with their equity investments.
- The Church Commissioners have had the sustainability of their commercial property portfolio assessed as above average.

Supporting initiatives to help reduce the threat and impact of climate change

- via active membership of the Institutional Investors Group on Climate Change which lobbies policy makers to put a price on carbon and hasten the transition to a low carbon economy.

Engaging with companies

- CCLA Investment Management (which manages and is majority owned by the CBF Funds) engages annually (on behalf of the £12bn ecumenical Church Investors Group of which the NIBs are members) with large UK companies demonstrating poor carbon emissions management to encourage improvements in the disclosure/management of carbon emissions.
- The NIBs are also part of the CCLA-led *"Aiming for A"* engagement initiative, which seeks leadership from the ten largest FTSE100 extractives and utilities companies.

4. In addition, in 2013, the NIBs were profiled in a case study of good practice in a survey commissioned by the networks of the Global Investor Coalition on Climate Change.

The EIAG's review of climate change policy

5. As the Southwark paper notes, the EIAG is already conducting a policy review to develop further the NIBs' ethical investment response to climate change. The biblical and theological grounding for policy on climate change and investment will be worked up further and will draw on material from 'Sharing God's Planet', 'Church and Earth', StF and the Ash Wednesday Declaration. The EIAG has established a theological sub-group which has had initial discussions. Issues identified for biblical and theological commentary include Creation, evolution, change and adaptation; stewardship and concern for others, especially the poor; justice and love of neighbour (including those not yet born); God's purposes for the non-human creation, including biodiversity; and the missiological dimension.

6. The EIAG is also taking expert advice on climate change and responsible investment, and is reaching out to stakeholders to gather views. A round table meeting was held in December with participants associated with StF, Operation Noah, A Rocha, the John Ray Initiative and the Dioceses of Southwark and London. As part of stakeholder engagement, selected stakeholders were asked to participate in a survey seeking views on the issues the EIAG is considering as part of the review. Notwithstanding any shortcomings in the survey, the majority of responses received indicated a preference for divestment from fossil fuel companies, although many were from people outside the originally selected group.

7. The reason why respondents were asked whether they favoured fossil fuel divestment even if it leads to financial detriment was because the law permits charities to maintain ethical investment policies in specific circumstances only, namely if:
   - a particular investment conflicts with the aims of the charity; or
   - the charity might lose supporters or beneficiaries if it does not invest ethically; or
   - there is no significant financial detriment resulting from the ethical investment policy.

8. Establishing whether stakeholders feel so strongly that they are prepared to accept the possibility of financial detriment is a way of determining the extent to which the C of E 'might lose supporters or beneficiaries' if the NIBs continue to invest in fossil fuel companies. Virtually identical constraints on ethical investment also apply to pension funds.

9. For the Pensions Board, key stakeholders in this debate are the employers and sponsors of its defined benefits schemes (all of which are non-contributory). It is these organisations that carry the investment risk and will have to contribute more to provide promised benefits should the Board's investment returns be lower for any reason. The EIAG is yet to conduct the further consultation with Dioceses, other sponsors and pension scheme members.

10. All three NIBs have strong investment track records for their global, multi-asset portfolios. The NIBs believe that integrating ethical and ESG factors into investment decision-making can improve financial returns. However, the risk of financial detriment from excluding sectors of the market from investment for ethical reasons is real, especially over shorter time periods, because investment opportunities are reduced. For example, 12.25% of the UK's FTSE350 stock market index (by market capitalisation) is already excluded from investment as a result of existing ethical investment policies. The difference between the investment returns from 2001 to 2012 of the FTSE350 and those of the FTSE350 minus companies excluded from investment was roughly -0.7% per year[1]. A further 14.25% of the FTSE350 would be excluded as a result of divestment from the 'integrated oil and gas' and 'oil and gas exploration and production' sectors. This would leave 26.5% of the index excluded from investment, and a higher risk of financial detriment.

The Southwark Diocese motion

11. In relation to the motion's first call, it is the EIAG's intention to ensure that the policy it recommends is aligned with the theological, moral and social priorities of the Church which find expression in 'Sharing God's Planet' and 'Church and Earth', and in the StF campaign. Indeed, the current policy was developed in order to align investment practice with the corresponding priorities set out at the time in 'Sharing God's Planet' and the StF campaign.

12. A specific area of policy alignment with the StF campaign which is not part of the NIBs' current climate change policy - emissions reduction targets - will be considered and the feasibility of setting carbon footprint reduction targets aligned with those of StF will also be examined. However, it is likely to be some time before the means exist to facilitate the assessment of the carbon footprints of complex multi-asset investment portfolios.

13. Although the recommendation in 'Church and Earth' that the NIBs move 'towards disinvestment' from fossil fuel extraction and supply companies does not have the same official status as the StF emissions reduction targets[2], it will be considered. No view has yet been taken on whether the EIAG should recommend that the NIBs avoid investment on ethical grounds on account of companies' involvement in the extraction of fossil fuels. From discussions to date a recommendation that the NIBs should disinvest from all fossil fuel companies seems unlikely. The EIAG is cognisant of the present need, in both the developed and the developing world, for fossil-fuel based energy and the fact that the transition to a lower carbon economy will take time. However, the merits of the exclusion of some companies from investment ('the option of disinvestment') will be fully considered as one of the tools available to the EIAG. For example, the EIAG will consider whether to recommend that the NIBs should implement, at this stage of the transition to a low carbon economy, ethical restrictions on investment in companies whose main business is coal mining.

14. It is important to emphasise that there are a range of ways of aligning investment practice with the theological, moral and social priorities of the Church which find expression in 'Sharing God's Planet' and 'Church and Earth', and in the StF campaign, other than through investment exclusions. Consideration of the extent to which the NIBs' influence as investors can be used for constructive impact will also be an important part of the review.

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[1] Includes the effect of compounding and uses average equity exposure and fund size over the period. However, whilst this 'cost' is realised in passive mandates, the extent to which it is realised in active investment management (or indeed whether it is realised at all) depends on how well the investment decisions of the active manager play out. For this reason the figure represents the 'opportunity loss', which may over-/under-state the actual loss.

[2] The 'Church and Earth' environmental strategy was written for Shrinking the Footprint but was not brought to General Synod; neither were its recommendations discussed with the EIAG or the NIBs.

15. The Southwark motion calls upon the EIAG to publish the report of its review by the end of 2014. Climate change is a particularly demanding area of ethical investment policy because carbon emissions are associated with almost all economic activity (not just coal, oil and gas extraction but also notably aviation, cement manufacture, and electricity, steel and petrochemicals production). Policy recommendations will need to be discussed carefully with the NIBs before they are finalised to ensure that they can be implemented and are consistent with the investing bodies' financial obligations to beneficiaries. Furthermore, it is expected that, during 2014, two major organisations - the Intergovernmental Panel on Climate Change and investment consultancy Mercer - will issue updates to their work on climate change, on whose analysis it would be highly desirable for the EIAG and NIBs to reflect.

16. The EIAG publishes ethical investment policies only after they have been agreed and adopted by the NIBs, a process which itself can take some months. It is possible therefore that the EIAG may not be able to recommend a policy to the NIBs before the end of 2014. It is, however, anticipated that the new policy will be published as soon as feasible in 2015.

Proposal for a working group on the environment

17. Alongside global poverty, climate change is perhaps the biggest moral, political and economic challenge of our time and requires concerted attention, and leadership, from the C of E. However, like poverty, it is not an issue that can be solved by investors or companies acting alone; it will require action by policy makers and by all individuals to ensure market demand and supply levels reach truly sustainable levels. The NIBs, EIAG and MPA Council welcome debate on the best organisational arrangement for coordinating and developing the C of E's strategic and local response to climate change. Decisions on this do not belong to the EIAG, NIBs, and MPA Council, but we would all be pleased to see a group established with substantive authority, a wide remit and the highest level of reporting, e.g. directly into the Archbishops' Council. We would be pleased to participate in the work of such a group.

18. It is worth noting that the existing StF Steering Group was set up on very much the lines proposed for the new group – outside the formal structures and ensuring that different stakeholders within the NCIs work closely together. It may be that the Synod debate suggests new dimensions and stronger authority for a new Working Group and if such a group is created it should replace the StF Steering Group, not duplicate it. Continuity with existing work should be maintained and the "value added" of the proposed new group should be clearly built into its remit.

Conclusion

19. The EIAG and the NIBs look forward to the Southwark motion being debated at this timely stage of the EIAG's policy review. The views of General Synod are an important touchstone for the EIAG and will be taken very seriously in deciding the outcome of the policy review and its eventual adoption by the individual NIBs.

The Revd Professor Richard Burridge Ethical Investment Advisory Group

Annex

ETHICAL INVESTMENT ADVISORY GROUP

CLIMATE CHANGE INVESTMENT FRAMEWORK

The whole creation belongs to God. As human beings we are part of the whole and have a responsibility to love what God has entrusted to our care. We are called to conserve its complex and fragile ecology, whilst recognising the need for responsible and sustainable development and the pursuit of social justice. The second Great Commandment calls upon us to love our neighbour; climate change reminds us that this applies to our neighbours of tomorrow as much as to our neighbours of today.

The national investment bodies of the Church of England accept the broad scientific consensus that greenhouse gas emissions from human activities are the most significant contributor to changes in the world's climate. The Church accepts that climate change is likely to result in profound consequences for human society, disproportionately affect the peoples of the developing world, and materially impact the world's natural systems and the global economy. We acknowledge that climate change therefore presents a series of material risks and opportunities for investors and companies.

The national investment bodies of the Church of England support a proactive approach that can help achieve substantial reductions in global greenhouse gas emissions. In addition, we recognise that to adapt to the risk of climate change is vital.

We recognise that:

- Greenhouse gases emitted into the atmosphere are causing environmental change and this will impact upon the companies and real estate assets in which we invest, and our asset management activities more generally.
- Current investment research, analysis, decision-making and shareholder ownership activities have the potential to reflect the risks and opportunities presented by global climate change.
- It is in the long-term interests of the ultimate beneficiaries of the assets we represent that climate change mitigation and adaptation should occur.
- By working collectively we, as investors together with agents, companies, regulatory authorities and governments can create an investment environment that contributes towards a low carbon economy.

As Church investors we will seek to:

- Build our capacity to understand and assess the investment implications of climate change by seeking ways in which the adverse impacts as well as the positive opportunities arising from climate change can be better understood.
- Work together as one Church, wherever possible, on initiatives that will help reduce the threat and impact of climate change.
- Encourage our asset managers to integrate consideration of climate change risks and opportunities in their investment research, analysis, decision-making and shareholder ownership activities.
- Explore ways in which our external advisors can be encouraged to consider the impacts and opportunities of climate change and climate change policy in the advice that they provide to us, for example in considering opportunities to invest in new technologies.
- Engage with the companies in which we invest to encourage an approach that minimises the risks, and maximises the opportunities presented by climate change. We will encourage companies to be transparent and accountable about their impact on climate change, for example by setting targets and timelines for reducing their greenhouse gas emissions.
- Explore ways in which a policy of assessment that measures, over time, the carbon footprint of the Church's investment portfolios can be developed.

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