

# Responsible investment approaches to non-equity investments

An introduction for charity trustees



**EIRIS/UKSIF Charity Project**  
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<sup>1</sup> see [www.uksif.org](http://www.uksif.org)

# 1 Introduction

This briefing paper explores the investment options in non-equity asset classes available to charities with Responsible Investment policies. It features the most popular asset classes amongst charities, highlights the issues trustees may wish to consider, and identifies some current investment options. The paper does not provide a definitive survey of Responsible Investment opportunities within each asset class and does not represent an endorsement of any of the featured products.

This paper has been produced to raise awareness of what is on offer for charities and where further developments may be required.

## This paper has been written in response to two key changes in charities' approach to their investments:

- 1) the greater number of charities wishing to invest responsibly and
- 2) the shift in some charities' asset allocation to a reduction in exposure to equities.

A recent survey by academics at Glasgow University found that 55% of large charities had a formal Responsible Investment policy and 9% an informal policy<sup>2</sup>. This compares to a survey in 2003 which reported that 40% of large charities had policies (whilst a third of those that did not were considering adopting one)<sup>3</sup>. These findings are supported by a number of other studies<sup>4</sup>.

Since the implementation of the Trustee Act 2000 and the downturn in the stock-market between 2000 and 2002, charities have increasingly considered investments in non-equity asset classes<sup>5</sup>. The JP Morgan Charity Investment Survey of 2005<sup>6</sup> found that in the previous 12 months the main reason given by 46% of charities for changing asset allocation was to increase or enhance portfolio returns. This finding contrasts with the survey's findings of 2004, when 55% of charities stated that they had made changes to portfolio allocation to control investment risk. Whilst the 2005 survey found that UK equities remain the most popular asset class for charities, non-equity asset classes remain an important option.

Asset class	Numbers of charity respondents (%)	Asset allocation of charity respondents (%)
UK equities	84	55.0
Overseas equities	50	8.6
UK bonds	71	8.5
Overseas bonds	19	0.4
Cash deposits	75	8.0
Property	35	11.6
Private equity	11	0.7
Hedge funds	13	7.2

Source: JP Morgan Charity Investment Survey 2005

2. Kreander, N. et al (2005) UK charity ethical investment: policy, practice and disclosure An interim report of ACCA research in progress, ACCA

3. Green, D. (2003) Do UK Charities Invest Responsibly? UKSIF, EIRIS and CAF [www.justpensions.org](http://www.justpensions.org)

4. For example the Charity Fund Partnership 'Survey of United Kingdom Charitable, Educational, Endowment and other Funds' 2003 and the JP Morgan 'Charity Investment Survey' (2003)

5. See UK Charities set to pick alternative investments, FTFM section in Financial Times, 25/03/02

6. [www.jpmorgan.com](http://www.jpmorgan.com)

According to the Charity Commission, “Trustees should try to consider the whole range of investment options which are open to them”, and “must consider the need for diversification, i.e. having different types of investment, and different investments within each type. This will reduce the risk of losses resulting from concentrating on a particular investment or type of investment.”<sup>7</sup>

For charities with Responsible Investment policies, part of the consideration of diversification and risk may be influenced by the investment options open to them in each asset class, that also fit with their policy.

To date, the focus of discussion on charities and Responsible Investment has been on equities, with little attention having been paid to other asset classes. This paper aims to partly redress this balance by seeking to help trustees to fully consider the Responsible Investment options that are open to them. By redressing this balance, coherence between responsible equity and other investments can be established.

## 2 What is Responsible Investment?

Responsible Investment is about aligning a charity’s investments with its objects. It is based on achieving the greatest impact from investments by **both pursuing maximum financial return** and **using investments for non-financial gain**.

There is no single model of Responsible Investment (which is often referred to as ethical or socially responsible investment (SRI)), rather it encompasses a number of different approaches which can be combined.

The approaches can be grouped under three headings; **support, avoidance and engagement**.

**Support**, sometimes called positive screening, is investing where there is a commitment to responsible business practices and positive products and/or services. This approach can manifest itself in a number of different ways including:

- investing in companies that sell positive products – for example educational material or essential necessities of life (food, clothing, electricity, water or housing),
- thematic investing – investing in specific areas such as environmental technology, or
- a best-in-sector approach – favouring investments with best practice amongst peers.

**Avoidance**, or negative screening, involves avoiding investments that do not meet the social, environmental or ethical (SEE) standards which the charity has set. There is no single correct approach to avoidance. The degree to which a particular behaviour is avoided will be determined by each charity’s policy.

**Engagement**, or shareholder activism, refers to the process by which investors use their rights relating to share-ownership to seek to improve or maintain SEE performance and encourage more responsible business practice. Engagement mainly takes the form of dialogue, negotiation and gentle persuasion.

A variety of techniques can be employed to apply these Responsible Investment approaches, depending on the different characteristics of each asset class. For example, property is a less liquid asset than equities and investors have different responsibilities (both for the building and towards tenants). Consequently there are different opportunities and challenges in developing Responsible Investment policies for each asset class.

<sup>7</sup> See CC14: *Investment of Charitable Funds: Basic Principles* at [www.charity-commission.gov.uk](http://www.charity-commission.gov.uk)

This paper focuses on investments that offer competitive returns (market-rate investments) where there is at least a reasonable argument for investing on financial grounds. It does not cover investments offering returns clearly below market rates which primarily seek to further the aims of the charity, sometimes known as programme related investments (PRI). PRI comes in a variety of forms: some are similar to conventional investments and in some cases distinguishing between market rate and PRI investments is not straightforward. Other forms may be easier to distinguish, such as Venturesome<sup>8</sup>, which falls outside of the scope of this paper. Under current guidance by the Charity Commission, PRI has to be treated separately from conventional investment.

In the case of private equity investments, the distinction between market rate and PRI investments can be particularly difficult to determine. However, there are growing areas where investment can be financially sound and further the work of the charity. An example could be an environmental charity wishing to invest in wind farms. This is an issue which trustees should carefully consider.

The term mission related investment (MRI) overlaps with Responsible Investment and PRI. MRI emphasises the importance of the mission when developing the investment strategy and is broadly similar to, and uses the same approaches as, Responsible Investment. However, MRI encompasses both market-rate and below market-rate investments.

In addition, this paper does not cover new structured products<sup>9</sup> as the options for charity investors are currently very limited.

### 3 The Case for Responsible Investment

Charities have cited various reasons for developing Responsible Investment policies. These include the avoidance of conflict with their aims, reputational risk, and concern about alienating supporters, beneficiaries and staff<sup>10</sup>.

Underpinning these reasons is the core **value and values case** for Responsible Investment.

- **Value** means shareholder value and refers to the advantage that charities can derive from Responsible Investment as long term investors. Many SEE and corporate governance risks and opportunities are relevant to investors, and incorporating them into the investment process can, therefore, lead to superior long term performance. The value case is relevant to all long term investors, including pension funds.
- **Values** refers to the decision to invest in line with objects and purpose and is particularly pertinent to charities. This is premised on the recognition that investments can provide social and environmental as well as financial returns and that investment decisions do not lie outside the work and mission of the charity. Values-based investment is, therefore, about ensuring that investments not only generate a financial return but that they also provide other benefits.

8. Venturesome provides custom-built funding for charities, who aim to repay the money. It aims to fill the gap in the financing spectrum between grants and bank loans.

9. For example, CAF has developed structured products that combine the features of deposit accounts and investments.

10. Further details can be found in the reports cited in footnotes two and three

## 4 Asset Classes

### For each asset class featured in this paper we have included:

- a)** a brief description of the asset class
- b)** a discussion on what the relevant Responsible Investment issues are
- c)** an explanation of how Responsible Investment operates in the asset class, with examples of investment opportunities
- d)** some further examples of investment opportunities

The cases drawn upon have been selected as examples only. The inclusion of a particular fund does not imply an endorsement of it. Moreover, the use of an example does not imply a recommendation of it over any other example or further example used or of any product not listed.

## 4.1 Cash Deposits

### Brief description

By cash deposits, this paper is referring to the opening of interest-bearing savings accounts with banking services. This includes deposits with high street banks and more niche organisations, including mission-related financial organisations.

### Responsible Investment issues

#### The issues a Responsible Investor may wish to consider fall under three headings:

- 1)** the types of businesses the bank would and would not offer services to (including lending)
- 2)** where the bank invests as principal, what it is willing to invest in
- 3)** the bank's business practices.

### How Responsible Investment operates

Developing a responsible approach to cash deposits revolves around the decision on which institution to bank with (this decision may differ from that for current accounts and other services). There may be scope to engage with the bank, but this could be difficult to achieve; this is particularly true when dealing with large international banks.

In choosing to deposit with a high street bank a charity is able to compare different banks' attitudes towards corporate social responsibility (CSR) and their policies on SEE issues. Banks are increasingly producing CSR reports and signing up to international agreements such as the Equator Principles or voluntary codes such as FORGE, which promote responsible behaviour in the banking sector. An investor may also wish to consider the bank's operations and employment practices.<sup>11</sup>

A charity may wish to avoid banks whose lending policy may conflict with their objects. For example, charities may wish to avoid banks that do not have sufficient policies and systems in relation to financial exclusion, the environment, equal opportunities, or for those banks that operate in countries with oppressive regimes where there are human rights abuses.

The Co-operative Bank has offered ethical banking on the high street for a number of years. It has a policy, developed in consultation with corporate and personal customers, which sets out precisely what ethical standards govern the types of businesses the bank would or would not offer services to.

11. The EIRIS Guide to Ethical Banking provides details of banks' policies and performance on major Responsible Investment issues including lending, financial exclusion and the environment. The Guide also provides an explanation of the major initiatives and codes. [www.eiris.org](http://www.eiris.org)

There are other options for cash deposits with the high street banks. For example there are a number of mission-based financial organisations which provide a focused range of financial services linked to certain social and environmental objectives. Triodos Bank only lends to organisations that create social, environmental and cultural value such as charities, social businesses, community projects and environmental initiatives. It offers interest-bearing deposit accounts that can be targeted at helping specific sectors. The Unity Trust Bank is a socially responsible organisation which provides services to charities, trade unions and other not-for-profit organisations. It offers deposit accounts for charities and has a strict policy on what it will finance. CAF Bank is a not-for-profit bank which offers interest-bearing current and deposit accounts specifically to charities, not-for-profit organisations, social enterprises and charitable trading subsidiaries. All revenue derived from these activities is re-invested in the charitable sector.

### Examples of other opportunities

- Charity Bank offers deposit accounts for individuals and invests deposits to provide charities with affordable lending products.
- COIF Charities Deposit Fund is for short term cash balances.
- Ecology Building Society offers a charity deposit account and uses deposits to grant mortgages on properties and projects that help the environment.

## 4.2 Fixed Income

### Brief Description

Fixed income securities, or bonds, are debt instruments created for the purpose of raising capital. Bonds are loans to organisations, which usually have a fixed rate of interest paid regularly and aim to pay back the capital at the end of the period covered by the bond. For the purpose of this paper, fixed income will be split into two categories; commercial, and government and supranational<sup>12</sup>.

Commercial bonds are debt issued by companies for which the company agrees to pay a fixed rate of interest to the lender. Government debt includes municipal bonds, central or federal government bonds, and bonds of related agencies. Government bonds are known as gilts in the UK, Eurobonds in the EU and Treasuries in the USA. A number of supranational institutions including the World Bank and the EBRD also issue debt.

All bonds are rated by mainstream rating organisations, such as Moody's and Standard & Poor's, using variants of a three or four letter system (such as Aa3 or BBB+). These assessments focus on the likelihood of the issuer defaulting on repayments. Whilst this assessment may take account of issues such as political risk, they **do not** systematically look at more general questions of sustainability and SEE risk.

### 4.2.1 Commercial Bonds

#### Responsible Investment issues

The Responsible Investment approach to commercial bonds is similar to that for equities. Many of the SEE criteria applied to equities also represent material risks and opportunities in bond investments. Bondholders can lose money on their investment should these risks materialise.

It is possible to screen some bonds, particularly corporate and special purpose bonds, according to avoidance criteria (for example to exclude tobacco or armaments) or support criteria (investing in best-in-sector companies or weighting a portfolio towards companies that produce positive products). In particular it is possible to access a number of entities and opportunities that are not accessible through the equity markets, e.g. bonds issued by the Co-operative Bank and the John Lewis Partnership, or special purpose bonds to finance social housing<sup>13</sup>.

There is limited scope for engagement with bonds, as investing in bonds does not confer the rights of ownership. Occasionally, it may be possible to influence companies when issuing bonds, and bondholders' influence grows if default is possible. Where there

<sup>12</sup> There are other debt instruments available to investors (for example convertible bonds, covered bonds and CDOs). They tend to be more esoteric and fewer charities invest in them. Instruments with Responsible Investment criteria have been issued. For example HBOS Treasury Services have issued UK social housing covered bonds

<sup>13</sup> An example is the Golden Lane Housing Investment Bond, issued through Triodos Bank, which raised finance to tackle the shortage of accommodation for people with learning disabilities. Bonds can be traded on Triodos Bank's matched bargain market 'Ethex'.

are no conventional shareholders, the issuers may be prepared to listen to their bondholders as representatives of the financial community (e.g. the World Bank).

## How Responsible Investment operates

As with equities, the Responsible Investment options for commercial bonds depends on whether the charity invests through pooled funds or through a segregated approach (this may of course be dependent on the size of the charity's investments).

There are Common Investment Funds (CIFs) which include Responsible Investment criteria in their approach. CIFs, constituted as charities in their own right, are pooled investment vehicles – similar to unit trusts – specifically set up for charities. The COIF Charities Fixed Income Fund does not hold corporate bonds that are issued by companies that are excluded by COIF equity funds. Therefore the Fund excludes bonds issued by companies whose main business is gambling, tobacco or armaments. The Affirmative Fixed Interest Fund for Charities mirrors the policy of the Central Finance Board of the Methodist Church which is to construct portfolios consistent with the moral stance and teachings of the Christian faith. The policy relates to issues including alcohol, tobacco, gambling, military, pornography, environment, extractive industries and human rights.

There are also Responsible Investment retail bond funds. The Rathbone Ethical Bond Fund has negative exclusion criteria and positive inclusion requirements for companies. The inclusion requirements include demonstrating progressive and well-developed policies in the management of environmental impact, human rights, positive products and/or community investment. The negative criteria cover a range of activities including animal testing, pornography and tobacco.

For charities with a segregated investment approach, it is possible to develop a bespoke policy by which the fund manager will screen bond investments (on both avoidance and support criteria) in line with the charity's policy. Fund managers also engage with companies which issue bonds and, therefore, when deciding on which fund manager to employ, a charity may wish to examine their engagement policies and records.

## Examples of other opportunities

- AEGON Ethical Income Fund is a retail bond fund that applies negative screens.
- Morley Sustainable Future Corporate Bond Fund is a retail bond fund that applies both positive and negative screens.

## 4.2.2 Government and Supranational Bonds

### Responsible Investment issues

The Responsible Investment focus with government debt differs from commercial bonds. A Responsible Investment approach is more focused on sustainability and environmental criteria. A country's performance against these criteria can be assessed and rated against indicators, other countries' performance or against international norms and conventions.

An investor may wish to assess environmental criteria by considering whether treaties have been ratified (such as Kyoto or Rio), or by levels of deforestation and emissions. In relation to governance and human rights, an investor may wish to assess attitudes towards social rights through assessing ratification of International Labour Organisation (ILO) core conventions. Civil liberties, gender equality or quality of governance (including corruption) can also be considered. These criteria can be applied to emerging and developing economies as well as to more established ones.

## How Responsible Investment operates

Responsible Investment approaches towards government bonds are less developed than those for corporate bonds. They also differ in that the approach may be about changing the weighting of a bond portfolio (to go overweight or underweight on a country bond) rather than avoidance. Similarly engagement is a different proposition (although it may be possible to engage with supranational bodies).

The Dexia Sustainable Euro Bonds fund's eligibility criteria for government issues relate to the democratic nature of the state and their respect for international agreements on human rights. The Sarasin Sustainable Bond Euro invests in issuers (countries, organisations and companies) who make a positive contribution to sustainable development. Countries are identified by their low and efficient consumption of environmental and social resources and organisations by their adoption of sustainable goals and efficient integration of the concept of sustainability in their use of resources<sup>14</sup>.

## 4.3 Private Equity (including Venture Capital)

### Brief description

Private equity tends to refer to investing in management buy-outs of unlisted companies. Venture capital refers to investments used to fund a new business venture (or 'start-up') in early stage expansion. Development capital refers to later stage expansions which may lead to a company being listed on the stock exchange. It is possible both to invest directly in companies or buy-outs and, more commonly, invest through a fund.

The structure of private equity and venture capital investments can often limit accessibility for charities, particularly those with Responsible Investment policies. For example, most venture capital investments are either through a limited partnership or a Venture Capital Trust (VCT). The minimum investment for limited partnerships is often more than £1million and the tax breaks and incentives associated with VCTs do not all apply to charities. There are also financial risks involved in such investments in small and start-up companies which charity trustees should investigate. In addition, very few VCTs are likely to comply with Responsible Investment criteria.

### Responsible Investment issues

With private equity the Responsible Investment issues, apart from what a company's core business is, revolve around whether the company is well-managed and acts sustainably. With venture capital (as distinct from buy-outs) and in particular project finance, it has been argued<sup>15</sup> that it is intrinsically a Responsible Investment as it directly encourages economic activity and growth and creates employment and other social benefits. More specifically, venture capital may provide attractive investment options for charities with interest in the environment, regeneration, health or learning.

### How Responsible Investment operates

In assessing the investment options within private equity, it is important to note that specific funds and opportunities may only be open for a limited period of time. Typically once an issue has raised sufficient capital it closes to further investments.

Responsible Investment in private equity and venture capital lends itself to a support approach. There are a number of specialist funds which invest only in responsible companies in specific sectors. Private equity investments tend to allow investors to be closer to the management of the company than with listed equities. This creates the opportunity for more detailed and developed engagement.

<sup>14</sup>. These fixed interest investment principles are also applied to the Sarasin Alpha Funds CIFs.

<sup>15</sup>. Mansley M. (2000) *Socially Responsible Investment: A Guide for Pension Funds and Institutional Investors*, Monitor Press

A large number of funds focusing on environmental technology or projects have been launched in recent years. Impax Asset Management has launched private equity and venture capital funds within the environmental sector, particularly in alternative energy, waste management and water treatments. Ventus is a specialist venture capital trust established to invest in a portfolio of companies that will develop, construct and operate small on-shore UK wind projects typically consisting of between one and six wind turbines. The Triodos Renewables Share Issue has allowed smaller investors (minimum investment £980) to invest in the renewable energy sector.

Bridges Community Ventures targets venture capital funding and business support at regeneration areas in England. It describes itself as building an investment portfolio of companies that, through their growth, will stimulate economic activity in those areas of most need. Bridges, as with all venture capital funds, aims to deliver a commercial return and offers an opportunity to actively support a sector or region of interest.

Robeco Asset Management invests in a variety of sustainable private equity funds in Europe and the US on behalf of their clients. There is a bias in these investments towards energy, water, waste, food and health sectors. A number of the leading mainstream investors and investment trusts in the private equity market have also invested in the renewables sector. For example HG Capital seeks investments in projects that use proven technologies including wind, small hydro, landfill gas and waste-to-energy.

## Examples of other opportunities

- Cleantech Venture Network is a forum which connects investors and entrepreneurs.
- Foursome Investments advises funds on early stage clean technology investments.
- KeyData has launched VCTs in renewable energy.
- Quadris Environmental Investments has provided opportunities to invest in forestry.
- WHEB Ventures Ltd manages a private equity fund for investment in early stage clean technology companies.

## 4.4 Property

### Brief description

Property suitable for investment by charities is usually commercial property. This can either be bought directly or through investing in a pooled property fund. Most property investing involves buying already built commercial property and renting it out, but it can also entail investing in a property development for sale.

### Responsible Investment issues

There are environmental, social and community aspects of property that a Responsible Investor may wish to consider. Many of the environmental issues relate to the sustainability agenda: energy efficiency, climate control, waste management, water consumption and pollution. Indeed the Association for Conservation of Energy believe that properties, through their construction, use and demolition, are the repository for around 50% of all carbon dioxide emissions<sup>16</sup>.

The social and community issues that may concern investors include accessibility, regeneration and the location of developments – building on greenfield or brownfield sites. Some charities consider the use a building will be put to before investing. Charities may prefer not to invest in buildings where the tenant is involved in activities which contradict the work of the charity or potentially risk the charity's reputation. Others may consider the construction process such as the sourcing of materials and the use of local labour.

16. Taken from speech by Paul MacNamara at the IPD/IPF UK Property Investment Conference 2004. Available at [www.prupim.com](http://www.prupim.com)

## How Responsible Investment operates<sup>17</sup>

A Responsible Investment approach to property differs from that for other asset classes. A property investor has obligations both for the property and towards the tenants. In relation to the tenant the scope for Responsible Investment lies with screening out certain types of tenants (although few funds offer this).

There are a wide range of both support and engagement opportunities in property investment. An investor is much closer to the impact of their investment than they would be with equity investment. Engagement can be hard hitting: in a new development, the investor may be able to influence how it is designed and built. As the investor is usually dealing with a handful of companies, they can also have a deeper engagement with property developers and builders (as opposed to engaging as part of an equity portfolio with a large number of holdings). An investor can also specifically invest in environmentally sustainable new buildings through the development process and in existing buildings where energy usage and emissions are controlled. Consequently, the value and values basis for Responsible Investment can be developed through property investments.

The investment options for charities are varied with different types of funds and approaches being applied. The Igloo Regeneration Partnership describes itself as investing in mixed-use urban regeneration projects in major towns and cities in the UK that are environmentally sustainable. Its projects vary between new developments on brownfield land and refurbishment of existing buildings. This is an option only open to the largest charity investors as the minimum investment is over £5million.

The Ethical Property Company represents an option for smaller investors. It buys properties and develops them as centres for charities and other not-for-profit organisations. The properties are based in areas of social exclusion and the Company works to minimise the environmental impact of its centres. It seeks to deliver social and environmental returns as well as financial ones to investors (who purchase shares in the Company which, once issued, can be traded on a matched bargain market). The COIF Charities Property Fund is a Common Investment Fund with a Responsible Investment approach. The Fund generally avoids purchasing properties with occupational leases where the main activity of the tenants contravenes the guidelines of the COIF Charity Funds' approach to Responsible Investment. The fund also assesses the environmental impact of its properties.

If regeneration or other specific Responsible Investment funds do not fit with a charity's investment aims, some mainstream property fund managers may provide an appropriate option. A number of managers incorporate Responsible Investment principles into their investment approach. For example, Hermes Property Asset Management has environmental and Socially Responsible Investment policies. The environmental policy is based on reducing environmental impacts and improving environmental performance. Through its Socially Responsible Investment policy it seeks to identify and assess the most significant risks to the portfolio's short and long term value arising from SEE matters. Prudential Property Investment Managers (PruPim) similarly seeks to manage its environmental impacts and performance. This includes promoting environmental protection and sustainable development and preventing pollution. This is pursued through an improvement programme which includes setting environmental objectives and continual monitoring.

Investing in listed property companies with strong social and environmental performance (usually considered as equity investment) may also interest some charities. For example the Workspace Group is involved in urban regeneration and the recycling of waste.

17. The Sustainable Property Appraisal Project led by Kingston University provides more information on why sustainability is an investment issue. [www.sustainableproperty.ac.uk](http://www.sustainableproperty.ac.uk)

## 4.5 Hedge Funds

### Brief description

Hedge funds provide an alternative approach to managing investments. They can seem relatively complex and are therefore not always well understood. Hedge funds generally can be classified according to the following criteria:

- 1) They usually emphasise absolute returns. In other words, unlike equity unit trusts they are not benchmarked.**
- 2) To make such a strategy possible, hedge funds use a wide variety of tools and strategies including leverage, derivatives and short-selling.**
- 3) Hedge funds have traditionally only been available to wealthy individuals and certain institutions.**

In recent years funds of hedge funds have been developed. These may make hedge funds more attractive to charities as they can provide diversified exposure to a number of different hedging strategies and reduce the risks involved in investing in a single fund.

### Responsible Investment issues

Some concern has been expressed over hedge funds as an option for Responsible Investors, on the grounds that hedge funds typically look at the short term and seek gains by exploiting market inefficiencies. As a result, for example, rather than seeking to address management inadequacies through governance they may either short the company or actively seek a takeover. The concern is that this may not necessarily be in the long term interest of the company, other shareholders or society as a whole. However, others might argue that hedge funds improve the efficiency of the market and that hedge funds applying SRI principles might increase the incentive for responsible corporate behaviour.

There are also issues about the level of risk involved in hedge funds and their lack of transparency and disclosure, particularly relevant for Responsible Investors. The inability to discover where a hedge fund is investing is a key issue for Responsible Investors. It is therefore important to fully understand how a hedge fund operates and the issues raised by critics of them when a charity is considering using hedge funds as a Responsible Investment option.

### How Responsible Investment operates

There are very few hedge funds or funds of hedge funds with Responsible Investment criteria on offer in the UK. One recently launched fund is the market-neutral Coolum Strategus SRI Fund<sup>18</sup>. This fund takes long and short positions in European companies depending on their social and environmental performance and record as well as on whether they are undervalued (long) or have poor financial prospects (short).

### Examples of other opportunities

- The Morley SRI Long Short Fund (SRILS) is the first SRI hedge fund in Europe. The objective of SRILS is to generate net returns in excess of 12% per annum by investing in large cap European equities.
- K2 Advisors are able to overlay negative screens to its funds of hedge funds. Through the analysis of portfolios, K2 Advisors can identify exposure to particular companies or sectors and establish offsetting equity positions to neutralise unwanted exposures. This approach allows investors flexibility in the screen they wish to apply.
- AIG Global Investment Group's Good Steward Fund seeks to provide absolute investment returns by using a broad range of alternative investment strategies and trading techniques, and offers daily socially responsible screening.

<sup>18</sup> The fund manager is Armajaro Asset Management which is authorised and regulated by the FSA

## 5 Conclusions and Agenda for the Future

This briefing paper, in examining some of the investment options, has shown that there are both challenges and opportunities in non-equity asset classes for charities with Responsible Investment policies.

The challenges relate to the limited range of products available in many of the asset classes. In particular there are suitability and accessibility issues. Some of the current investment options also do not fit with the risk profile of charities or their overall asset allocation strategies. Moreover, the structure of investment vehicles and the minimum initial investment sums often preclude charities, as with some property and venture capital funds.

However, as the non-equity investment market develops, charities may be in a good position to help shape what becomes on offer. New research and products are being developed in a number of different areas, including government bonds, hedge funds and venture capital. Much of this work has been driven by the demand from institutional investors including pension funds and family foundations for innovative and sustainable products. For example, the Environment Agency Pension Fund – as part of its revised investment strategy – has appointed a private equity fund manager to invest in a variety of funds within positive sectors such as waste, water and health. A number of other public sector pension funds and family foundations have invested in Bridges Community Ventures and in renewable energy and clean technology funds.

Charities may wish to explore collaborations that could build opportunities appropriate for the sector. At one level this could be encouraging fund managers to offer new Common Investment Funds and other products in fixed interest, property or hedge funds asset classes that incorporate Responsible Investment concerns and approaches. Some charities may also wish to consider more innovative investments. For example, in venture capital, charities may wish to set up a pooled fund that allows for a 'fund of funds' approach; the combined value of the fund is invested in a range of venture capital or private equity vehicles. This may suit charities as it spreads risk (as the number of investments in a portfolio increases), the fund's risk profile can match that of charities and the minimum investment level may be accessible for more charities. Innovations in property investment could include charity investors developing properties for other charities to lease for office use or service provision, such as hospices.

On the policy side, the charity sector may wish to examine how the current investment and fiscal framework could create more incentives for charities to invest responsibly (particularly around sustainability or regeneration agendas). For example some of the tax incentives for investors in VCTs are not applicable to charities. Charities may therefore wish to explore whether there are other ways of creating incentives.

There may also be something to be learned by looking at the experience of charities in other countries, while noting the different charity, fiscal and investment frameworks. In the US a number of foundations and other organisations have obtained positive returns from investing in social housing and social enterprises. Some Catholic investors in the US are investing in a hedge fund which screens investments according to Catholic values.

A number of US foundations have pioneered the use of mission related investment to achieve market rate returns. As mentioned earlier, MRI has considerable overlap with Responsible Investment when considering market-rate investments. It is an area that has sparked much interest and debate in the UK and is likely to develop in future years.

The opportunity is there for charity trustees to develop an investment approach which both provides the financial return (and diversification) required and which allows them to use investments for non-financial gain: to further the purposes of the charity. This briefing paper and the options presented throughout will hopefully help charities with a wide range of missions and approaches to benefit from non-equity Responsible Investment.

## 6 Website Links

The list below provides website links for all the investment products included in this paper:

AEGON Ethical Income Fund  
[www.abetterway.co.uk](http://www.abetterway.co.uk)

Ethical Property Company  
[www.ethicalproperty.co.uk](http://www.ethicalproperty.co.uk)

Quadris Environmental Investments  
[www.quadris.co.uk](http://www.quadris.co.uk)

AIG Global Investment Group  
[www.aig.com](http://www.aig.com)

Foursome Investments  
[www.foursome.net](http://www.foursome.net)

Rathbone Ethical Bond Fund  
[www.rathboneunittrusts.com](http://www.rathboneunittrusts.com)

Bridges Community Ventures  
[www.bridgesventures.com](http://www.bridgesventures.com)

Hermes Property Asset Management  
[www.hermes.co.uk](http://www.hermes.co.uk)

Robeco Asset Management  
[www.robeco.com](http://www.robeco.com)

CAF Bank  
[www.cafbank.org](http://www.cafbank.org)

HG Capital  
[www.hgcapital.net](http://www.hgcapital.net)

Sarasin Sustainable Bond Euro  
[www.sarasin.co.uk](http://www.sarasin.co.uk)

Charity Bank  
[www.charitybank.org](http://www.charitybank.org)

Igloo Regeneration Partnership  
[www.igloo.uk.net](http://www.igloo.uk.net)

Triodos Bank  
[www.triodos.co.uk](http://www.triodos.co.uk)

Cleantech Venture Network  
[www.cleantech.com](http://www.cleantech.com)

Impax Asset Management  
[www.impax.co.uk](http://www.impax.co.uk)

Unity Trust Bank  
[www.unity.uk.com](http://www.unity.uk.com)

COIF Charities Deposit Fund, COIF Charities Fixed Income Fund and COIF Charities Property Fund  
[www.ccla.co.uk](http://www.ccla.co.uk)

John Lewis Partnership  
[www.johnlewispartnership.co.uk](http://www.johnlewispartnership.co.uk)

Venturesome  
[www.cafonline.org/venturesome](http://www.cafonline.org/venturesome)

Coolum Strategus SRI Fund  
[www.armajaro.com](http://www.armajaro.com)

K2 Advisors  
[www.k2advisors.com](http://www.k2advisors.com)

Ventus  
[www.ventusvct.com](http://www.ventusvct.com)

Co-operative Bank  
[www.co-operativebank.co.uk](http://www.co-operativebank.co.uk)

KeyData  
[www.keydata.co.uk](http://www.keydata.co.uk)

WHEB Ventures Ltd  
[www.whebventures.co.uk](http://www.whebventures.co.uk)

Dexia Sustainable Euro Bonds  
[www.dexia-am.com](http://www.dexia-am.com)

Morley SRI Long Short Fund (SRILS) and Morley Sustainable Future Corporate Bond Fund  
[www.Morleyfm.com](http://www.Morleyfm.com)

Workspace Group  
[www.workspacegroup.co.uk](http://www.workspacegroup.co.uk)

Ecology Building Society  
[www.ecology.co.uk](http://www.ecology.co.uk)

Prudential Property Investment Managers (PruPim)  
[www.prupim.com](http://www.prupim.com)

### Disclaimer

This publication is intended to be for information purposes only and it is not intended as promotional material in any respect. The material is not to be used as investment advice or legal advice, nor is it intended as a solicitation for the purchase or sale of any financial instrument. The report is not intended to provide, nor should it be relied on, for accounting, legal or tax advice, or investment recommendations. It should not be taken as an endorsement or recommendation of any particular company or individual. Whilst based on information believed to be reliable, no guarantee can be given that it is accurate or complete.

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The EIRIS/UKSIF Charity Project encourages and assists charities and their trustees in the development of an ethical and socially responsible approach to their investments through education, research and the provision of resources.

It is a joint project between the EIRIS Foundation and the UK Social Investment Forum (UKSIF).

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## **EIRIS/UKSIF Charity Project**

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