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Pulse

Deloitte's Charities and Not for Profit Group Newsletter

Welcome to the new edition of PULSE.

We are fortunate in this edition to have two views on governance, a reminder of why good governance is important and also what good governance may look like.

For those struggling with managing pensions and investments our articles on defined benefit pension schemes and sustainable investments make for an interesting read.

Thanks for reading!

Reza Motazedi

Please note that the views expressed in this publication are those of the authors and not of Deloitte. In the complicated environment in which we all operate, always seek professional advice specifically and don't rely on contents of articles that have been written for general guidance only.

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Poor governance – the latest charity bad news story?

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The recent high profile governance failures of large national, household name charities have caused ripples of concern amongst other trustee boards, keen to ensure that they do not become the next tabloid headline.

Kids Company, RSPCA and Oxfam, to name just a few, have been exposed in relation to fundamental governance shortcomings and all have become the subject of Charity Commission attention. For the trustees, who are often pre-eminent in their own fields, this brings embarrassment and reputational damage, (at least by association), and months, if not years, of living under the strain of being 'under review'. There is also the possibility of being disqualified, as a company director, and / or as a charity trustee, and although rare, the possibility of being found personally liable for breach of their fiduciary duties.

So how have experienced and distinguished trustees found themselves in this situation and what basic steps can trustee boards take to protect themselves against a similar fate?

Be actively involved

Individual trustees can protect themselves by being reliable active trustees. This means regularly attending meetings, being briefed and ready to participate in discussions. Trustees need to be vigilant in their role to safeguard and maximise the charity's assets and prepared to set limits, initiate strategy and policy, and able to question the way things are done. They need to be personable, good communicators and ready to get involved and play their part in fostering morale and goodwill within the organisation and externally.

The charity governance code

The Charity Governance Code (the Code) has been developed by an independent voluntary steering group, formed of various umbrella bodies and interested parties. The Charity Commission has endorsed the Code by signposting trustees and others to the Code in the place of its own former guidance on the same topic.

The Code is intended to be a practical tool to help charity trustees to identify and develop high standards of governance. It is not a legal or regulatory requirement. Instead the expectation is that trustees should apply the relevant parts of the Code, or explain why it has not been necessary or appropriate for them to do so.

The Code assumes that all trustees will be committed to fulfilling their role to the best of their abilities, in compliance with their basic legal and regulatory responsibilities. On top of those foundations lay the seven governance principles: organisational purpose, leadership, integrity, decision making, risk and control, board effectiveness, diversity and openness and accountability.

Every trustee board should read and discuss the Code and its applicability to their organisation and make an action plan in relation to areas in which they are found lacking.

Trustee training

The outcome of many Charity Commission Inquiries, or Commission action plans set out the requirement for the trustees to be better trained. The best governed charities ensure all new trustees are given a crash course on appointment to give them an understanding of matters relevant to their charity and an awareness of their general legal duties and responsibilities. On top of that, refresher courses, or an annual round up of necessary updates, presented either before or at the end of a trustee board meeting are the best way to ensure that all trustees, whatever their professional status, or experience, have been suitably inducted and trained to recognise and act on potential issues. As a speaker at trustee training events, I am frequently told by those who have spent many years working in the sector that they have learnt something new, and regular training (even for experienced charity trustees) is a necessary part of being a vigilant, prepared and well informed trustee.

Governance review

Many of the charity trustees we speak to, mindful of the current climate, are, or have recently undergone a governance review. There are many ways of undertaking such a project and the approach taken may be dictated by whether or not the review is undertaken by a lawyer or an accountant. The legal approach is usually a 'top down' approach and often starts with a review of the legal structure of the charity, the governing documents and other necessary documentation e.g. committee terms of reference and policies and procedures and will report on any deficiencies and updates required. Reviews undertaken by accountants and others are often more 'bottom up' and involve an assessment on the ground about how the charity functions, how matters are delegated, reporting lines and the structure and governance framework. Both formats usually result in a written and oral report for the trustees and both usually use the Code as a guide to structure the review and measure the charity against the requirements.

Good governance isn't rocket science and much of it is common sense. It is about making sure that the charity has the right structure, fit for purpose governing documents and equipped with the right (available, skilled, vigilant, prudent and questioning) trustees and paid executives who are fully supported and resourced to carry out their role. Everyone needs to be in the position to pull together to further the charity's charitable purposes. The trustees cannot go too far wrong if every decision taken is approached with the question, "is this action (or omission) in the best interests of the charity?" If the decision taken is a reasonable decision and can be justified, then the scope for getting things wrong is minimised and trustees can enjoy being a trustee without suffering too many sleepless nights!

Good governance in charities is fundamental to their success

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Last year, BEIS issued legislation requiring large companies to report on various aspects of corporate governance. At the same time the Charity Commission published their research into trust in charities, identifying that being 'well-governed and well-managed' was one of the five key drivers of trust in charities. Whilst charities are exempt from the BEIS reporting requirements, they are under ever-increasing scrutiny in respect of both their governance activities and their impact. Trustees and senior management need to make governance a top priority and be transparent about their governance approach in their annual Trustees' Report.

The importance of good governance

Governance is best described as "the systems and processes concerned with ensuring the overall direction, effectiveness, supervision and accountability of an organisation".

The Charity Governance Code, published in 2017 ("the Code"), explains that effective governance, along with the right leadership structure, gives charities the best chance of achieving their aims and ambitions, as well as enabling and supporting their compliance with relevant legislation and regulation.

The Code is rightly aspirational and is designed to help charities and their trustees develop high standards of governance. It notes that "as a sector, we owe it to our beneficiaries, stakeholders and supporters to demonstrate exemplary leadership and governance". The Code combines traditional governance framework matters with board effectiveness considerations, placing considerable emphasis on the 'people around the table' and how they interact.

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When organisations get it right, good governance can mean a confident, forward thinking organisation, where the Board is abreast of its duties, and activities and services are well planned and well managed. However, passive governance can lead to an organisation "coasting" with no real sense of direction or drive, where the Board is unclear as to how best it can contribute and potentially unprepared for eventualities.

It is therefore critical to have not just an effective governance model, but more importantly an effective Board to lead it. The "tone at the top" is the key to success and the right tone can energise and direct an organisation to achieve its strategic objectives whilst maintaining an appropriate level of control and compliance.

Good governance at every level

The Board does not, and cannot, act in isolation and every level of the organisation has its part to play in an effective governance model.

At a strategic level, the chief executive and senior management team should develop an organisation-wide integrated business plan which directly links front-line activities with the organisation's priorities and values to demonstrate achievement of the overall objectives and vision. It should be clear how each activity contributes to the objectives and vision, both financially and qualitatively, and what risks would prevent that contribution.

At an operational level, management should ensure that performance reporting is designed to identify and comment on the key performance indicators in a manner that would alert senior management and the Board to an issue before it became critical. Management should also maintain and own the risk register and be continually assessing the effectiveness of activities undertaken in order to minimise risks of not achieving the plan.

At the grass roots level, staff should be aware of the internal controls in place, whether financial or operational, whether back-office or front-line. A culture of effective communication is vital to encourage staff at all levels to contribute to the effective governance of an organisation. This can be through reporting potential fraud and irregularities, but perhaps more importantly by making suggestions for operational or financial changes and improvements.

It is certainly true that when the whole organisation works together it becomes stronger, more flexible and better able to react to risks and take advantage of opportunities.

The secret to an effective board

At Deloitte, we consider that a Board has **three key roles**:

1. gaining insight and foresight;
2. clarifying priorities and defining expectations; and
3. holding to account and seeking assurance.

Key: Inner circle – key roles; Outer circle – enablers

Gaining insight and foresight

The Board as a whole, and individual trustees, should be aware of key government policy, legislation and economic drivers that could impact their organisation. They should consider these external factors alongside the current and future needs of key stakeholders and should engage in debate regarding the opportunities and threats such external factors and stakeholder needs bring to the organisation. The extent to which the organisation currently can, and in the future wishes to, respond to these stakeholder needs and environmental conditions should be a key focus of strategy discussions at Board level and a Board's effectiveness will depend on the level of their understanding and engagement in such matters.

Clarifying priorities and defining expectations

It is important that the Board debates, agrees and clearly communicates a set of strategic priorities for the organisation and how it expects these priorities to be delivered. The "tone at the top" is a key factor and it is all too easy for a successful or asset-rich organisation to become complacent and "coast" in the good times rather than continue to assess their priorities and re-evaluate their strategic direction.

Holding to account and seeking assurance

Last, but by no means least, the Board should be able to understand and critically appraise performance information so that they can offer supportive challenge to management and ultimately hold management to account. All too often, Boards are presented with inappropriate or indigestible performance information meaning that the trustees spend excessive time in review, or worse, do not review at all, assuming others will pick up this role. A simple dashboard with traffic lights is often more effective than volumes of detail. As part of their duties as charity Trustees, the Board needs to be reasonably assured that management are delivering the strategy in line with the Board's expectations, since this should ultimately ensure that the organisation is acting within its compliance framework and delivering its charitable objectives.

A Board's ability to perform these key roles effectively is dependent upon various enablers (the outer circle in the diagram) considered below:

- the Board has the right balance of skills, knowledge and experience to govern the organisation effectively;
- the Board engages with its internal and external stakeholders on a timely basis;
- the Board's Committee structure is clear and provides trustees with assurance to discharge their duties effectively;
- the Board's meeting agenda and forward plan ensures that trustees are focusing on the right areas at the right time;
- the information received by trustees is comprehensive, accurate, easy to understand, timely and appropriate;
- the Board operates effectively as a team, striking the right balance between trust and challenge;
- the Chairman is an effective leader of the Board; and
- the Board and its trustees are continually improving as a group and as individuals.

Common pitfalls

So what are the most common causes or indicators of poor governance? In our experience, the top three are:

a. Long service of trustees – a stable Board can be good for an organisation but it can also lead to the relationships with management and other trustees being too 'comfortable'. This can result in the level of effective challenge diminishing over time and hence it is important to have a maximum term for serving on the Board so that fresh perspectives are regularly brought to the table by new trustees.

b. Imbalance of power – this can be either a dominant chief executive (CEO) or a dominant Chair of the Board. A dominant CEO will sometimes 'manage' the Board and its meeting agendas, for example the strategic direction is driven by the CEO with minimal input or challenge by the Board, or only selected matters are taken to the Board for discussion or approval. In the case of a dominant Chair, the CEO and management team can be undermined as the Chair strays into management territory. This reduces the ability of the Board to hold management to account if they have been involved in those management decisions.

c. Unclear Board meeting procedures – this is often illustrated by agenda points that do not have a clear purpose or minutes that do not show conclusions or decisions. Where minutes simply record discussions, the reality is often that the Board meetings are ineffective with plenty of discussion and comment, but no real challenge or evolution of the agenda point into a decision or conclusion. Good governance involves effective challenge from the Board, and effective challenge is aided by focused agendas, which clearly state the decisions required, and an effective meeting Chair.

Evaluation of board effectiveness

A Board's structure and processes are often historic, evolving over time as trustees change. An effective Board should seek to perform a critical self-evaluation and appraisal periodically to ensure it is proactive, and not reactive, as the world around it changes. It is also worth remembering that as charity Trustees, individuals are jointly responsible for Board decisions, irrespective of whether they were present when a decision was made, so effective team work is particularly important.

There are various checklists and toolkits available to aid such reviews and these are a good start to raise awareness of the Board's responsibilities. However, it can be difficult to perform a critical self-assessment and what does "good" look like anyway? It is not enough to tick through a checklist, an organisation needs to actively determine whether its Board and governance activities are truly effective, whether they are adding value and helping to achieve the strategic objectives.

The Charity Governance Code places considerable emphasis on the 'people around the table' and how they interact and therefore it is important that evaluation should go beyond a desktop review and should spend time understanding the culture and relationships behind the governance framework of an organisation. Effectiveness should be evaluated at both the individual and group level, i.e. the Board or senior management group as a whole. Talking to, and observing, Trustees and management to understand their styles, skills, interactions and views will give valuable insight into Board effectiveness compared to a paper-based desktop review of policies and minutes.

Try this quick self-assessment – how does your organisation measure up?

- Can all staff articulate the organisation's strategic priorities?
- Does the Board give effective scrutiny and challenge?
- Are outputs explicitly linked to strategies and risks?
- Is there sufficient clarity of roles and responsibilities?
- Are the appropriate key performance indicators identified?
- Do staff feel involved in developing the strategy?
- Do Board reports articulate the risks?
- Is there too much data and not enough information?
- Are decisions captured and key actions owned?
- What is the perception of external stakeholders?
- Is there follow up on key actions?
- Is the Board disconnected from its beneficiaries or front-line staff?

How can charities cut defined benefit scheme costs?

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In March 2018, the UK Government published a White Paper, entitled 'Protecting Defined Benefit Pension Schemes'. If you are a sponsor, trustee or even a member of a defined benefit scheme, the White Paper may hold some relevance for you, as it is opens the door further to pension scheme consolidation.

Running a defined benefit pension scheme

Running a Defined Benefit ("DB") pension scheme is an expensive business. Whilst many schemes in the U.K., including those operated by many charities are closed to future accrual, running legacy DB schemes remains a challenge: investment management charges, administration costs and governance fees can all be very high, and this is before adding in deficit reduction contributions. By bringing small and medium sized DB schemes together, these running costs can fall significantly. The challenge is how you consolidate these schemes in such a way that sponsors and trustees retain control over their share of the assets and liabilities, and such that risks and deficits are not shared. After all, whilst you may not like your deficit you are unlikely to want a share of anyone else's.

New regulation

In March 2018, the UK Government published a White Paper, entitled 'Protecting Defined Benefit Pension Schemes'. Unless you are a pensions professional, it is highly likely that this event passed you by. However, if you are a sponsor, trustee or even a member of a defined benefit scheme, the White Paper may hold some relevance for you, as it is opens the door further to pension scheme consolidation. The Department for Work and Pensions ("DWP") has committed to finding ways to help build confidence and encourage existing forms of consolidation, and to raise awareness of the benefits of consolidation with trustees and sponsoring employers. Consolidation may take a variety of forms, but it essentially involves the pooling of administrative functions and/or assets and liabilities, with a view to reducing costs and improving governance.

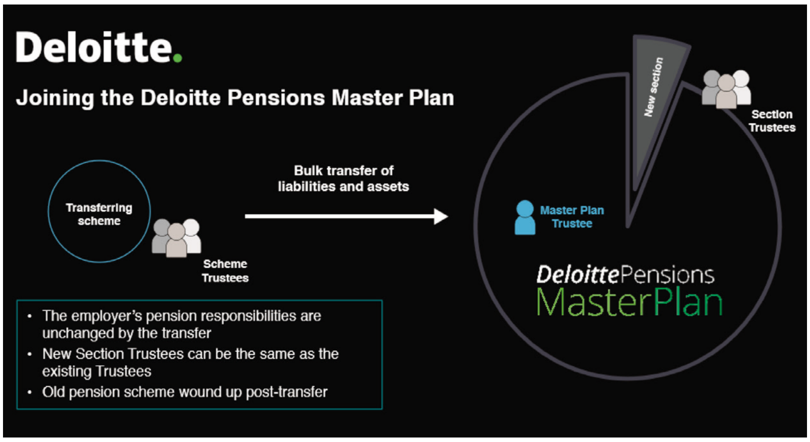
For DB schemes, a Master Trust can provide a safe way of doing just this. A Master Trust works by bringing DB schemes together within a fully sectionalised umbrella scheme. By doing this, investment management costs (or Annual Management Charges ("AMCs")) are reduced – often significantly. AMCs represent one of the most significant running costs of a DB scheme – potentially around 75% of the total annual running costs – far higher than the costs of administration or actuarial services.

In the past, the benefit of economies of scale from a Master Trust could come at a cost, with pension scheme trustees and employers losing some of the control and flexibility of their schemes – but this is no longer the case. There remains a fear factor over pensions. Even the most sophisticated businesses think there is no fix or that the fix is too complicated. People think there's nothing new in pensions and that they've seen everything before, but there are other options out there, our Deloitte Pensions Master Plan is one of those.

The Deloitte Pensions Master Plan

The Deloitte Pensions Master Plan ("the Master Plan"), launched in 2015, is open to DB schemes, with current scheme trustees retaining full control of assets and liabilities. Participants have ranged in size from schemes with less than 100 members and around £10m in assets to those with multiple thousands of members and almost £1bn in assets. They have come from a wide range of industries including financial services, the aeronautical sector, the fashion sector and the communications sector. Deloitte's own defined benefit pension scheme, which has assets under management in excess of £900m, is in the process of moving into the Master Plan.

The Deloitte Pensions Master Plan consolidates DB schemes into a single trust where schemes can benefit from reduced fund management and administration charges. For one Deloitte client, its pension scheme's ongoing expenses reduced by 30% after moving into the Master Plan.



There may also be the opportunity to carry out some 'tidying-up' of some of the smaller benefits in the scheme at the point of transfer. This can remove some of the benefits in the scheme which are disproportionately costly to administer and shorten the overall lifetime of the scheme.

The White Paper reflects the pension industry's call for greater innovation and consolidation and this scheme reflects the way that pensions may be managed in the future as the industry innovates to support trustees and sponsors to manage their pensions' costs.

Could my scheme save money?

If you are a charity and the sponsor of a DB benefit scheme then investigating the products available in the market may give you some options to tidy your scheme and save costs.

The evolution of responsible investing

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In recent years, there has been a growing interest in responsible (often referred to as sustainable) investing. However, responsible investing is no fad, nor is it something new to the world of asset management. Its origins can be traced back to the 19th century, when UK and US faith-based investors such as the Quakers and Methodists, who were opposed to the slave trade, smuggling and conspicuous consumption, were among the first groups desiring some form of ethical screening in line with their religious beliefs.

This ethical or 'negative' screening of stocks that contravene certain religious beliefs has continued to this day and represents one of the broad styles of responsible investing that are available to investors.[1] We will address the different styles in more detail later in this article.

Back to the more recent rise of interest in responsible investing, it could be argued that the message of investing for reasons other than purely financial gain became lost somewhat behind the imperative of making money at all costs. In 1970, the celebrated US economist Milton Friedman published a mould-breaking article that helped to change the way many people thought about the world.

In a nutshell, Friedman argued that companies' sole purpose was to generate money for shareholders. He asserted that not only were businesses with a 'social conscience' less competitive, but that they also put shareholders' profits at risk.[2] Friedman's argument had a huge influence on the actions of companies and investors in the 1970s right through to the 1990s, with banks and other financial groups going for ever bigger profit margins. Through the 1980s and 1990s, Gordon Gekko's trader mantra in the film Wall Street that "greed is good" became the prevailing attitude for many.

[1] Source: medium.com/project-invested/faith-based-investors-chart-a-fresh-path-to-social-impact-fa0685fcf965
[2] Source: New York Times: The Social Responsibility of Business Is To Increase Its Profits, 13 September 1970.

By the late 1990s and early 2000s, that approach was starting to be replaced by a growing desire in some quarters for a more responsible approach to investing. The conversation has changed substantially since the last decades of the 20th century – and companies and investors have reacted accordingly.

The UN's role in raising responsible investing's profile

While it is difficult to pinpoint exactly when the tide began to turn, some of that change in attitude can be attributed to the efforts of the United Nations (UN). There was a growing awareness of environmental issues and, in particular, concerns over the impact of climate change on the planet, with the UN playing a key role in driving awareness of the issue.

In 1999, the UN created its Global Compact, which asked investors to sign up to ten sustainable/responsible principles to be considered alongside their financial approach. In 2006, the UN went further by launching its Principles for Responsible Investment (UNPRI), with investors asked to sign up and adhere to a range of sustainability-focused principles. Newton was an early adopter, signing up to the UNPRI in the following year.

As investor appetite for a more responsible approach has gradually risen, other considerations have also played their part alongside environmental concerns. There has been a growing awareness of social inequality, while greater prominence has been given to companies' behaviour, in terms of accountability and transparency around corporate governance. The integration of environmental, social and governance (ESG) considerations into companies' investment processes has also gained traction, while in some cases that integration has been taken a step further with the launch of sustainable strategies, where more emphasis is put on areas such as positive societal and environmental outcomes. Such strategies might actually exclude otherwise financially strong companies if their ESG profile is negative.

Across the range of approaches being followed by investors, the overall sector has grown exponentially. By the end of 2016, over $22 trillion of investors' assets were managed under responsible investment strategies globally, representing 26% of global assets managed, and an increase of 25% since 2014.[3]

US growth and the rise of climate change awareness

In the US alone, strategies run along sustainable, responsible and impact investment lines totalled $12 trillion by the start of 2018, equating to a 38% increase since 2016, with respondees citing climate change/carbon as their single most pressing concern.[4] Environmental concerns, particularly around climate change, have played a key role in driving that growth.

By September 2018, over 550 investment management firms had signed up to the UNPRI accord,[5] while the Taskforce on Climate-Related Financial Disclosures (TCFD) has provided a global framework to translate non-financial information into financial metrics. By June 2018, the TCFD had been endorsed by over 286 companies[6] including 160 financial institutions with around $86.2 trillion assets under management.

Having become a TCFD signatory in 2018, Newton produced its first annual TCFD report in November 2018.

Defining the broad universe of responsible investing

We have established that investors' appetite for responsible investing is continuing to grow on a global scale, but how do investors decode the different names applied to the various types of responsible investment, and, more importantly, how do they determine which best suits their specific purposes?

The Cambridge University's Institute of Sustainability Leadership (CISL) lists no fewer than nine separate areas of responsible investment, set out as follows:

Ethical investment

This usually refers to the use of a 'negative' screen to exclude entire sectors or companies that are engaged in activities deemed unethical by the investor, or against a set of beliefs. Typically, this may include alcohol, tobacco, pornography or weapons, and it can sometimes include nuclear power, gross violations of human rights or companies doing business with or in a particular country.

Socially responsible investing (SRI)

The CISL defines SRI as an investment approach that applies ESG criteria alongside more traditional financial metrics when evaluating companies for investment. Generally, SRI investors score companies against their chosen criteria, and this analysis is used along with the financial assessment to decide whether an investment is made.

[3] Source: Global Sustainable Investment Review 2016, Global Sustainable Investment Association (GSIA), March 2017

[4] Source: pionline.com/article/20181031/ONLINE/181039969/us-sif-investment-in-sri-grows-to-12-trillion-in-us?newsletter=editors-picks&issue=20181031#

[5] Source: unpri.org/asset-owners

[6] Source: fsb-tcfd.org/wp-content/uploads/2018/07/TCFD-FAQ-Supporting-the-TCFD-Recommendations-June-2018.pdf

Sustainable investment

The CISL defines sustainable investment as a portfolio composition based on a selection of assets that are can be defined as being 'sustainable' or set up to continue into the long term. If the criteria used to judge whether or not the investments are sustainable are set via typical ESG considerations, then the label is little different to 'best-in class' funds or those that integrate ESG into their investment approach. In other cases, it may be applied to investments where the criteria to buy are founded upon selection terms such as 'industries of the future' or 'net positive business operations'.

Best in class (ESG) integration

The CISL define this as investment portfolios that actively select investments from only those companies which meeting the requirement of certain ESG criteria. The qualifying companies might be those that sit within the top 20 or 30% of companies assessed.

ESG integration

This category is differentiated from best in class in that the CISL terms it as a more in-depth analysis of a company's ESG credentials. Areas that ESG analysts may review include business model, product strategy, distribution system, research and development, and the human resources policies of a company.

Thematic investment

Whether a thematic fund would qualify as an SRI fund would depend not only on the theme it invests in, but also the environmental and social attributes and impacts of companies in the fund. Thematic investment as an investment strategy can be clarified as one that falls under a specific investment theme. Examples could include: water distribution, agriculture, low carbon energy, pollution-control technology, health care, climate change and information technology.

Green investment

The CISL refers to green investment where an investment approach seeks to invest in 'green' assets whether they are funds, companies, infrastructure or projects. The sort of areas covered within this range might include low carbon power generation and vehicles, smart grids, energy efficiency, pollution control, recycling, waste management and waste of energy, process innovation, and other technologies and processes that contribute to solving particular environmental problems.
In many cases, it might be absorbed within the thematic investment category.

Impact investing

Impact investing is usually defined as investments that seek a particular social or environmental objective, such as providing employment in a community, promote access to low carbon energy, or support minority-owned businesses or businesses that employ people recovering from drug addiction or with disabilities. Unlike philanthropy, where the individual is seeking no financial return, its purpose is to meet the financial objectives of the investor.

Shareholder engagement

Shareholder engagement is defined by the CISL as the influence that is brought to bear on a company by shareholders on ESG-related issues. This can be done through dialogue with corporate officers, the submission of questions or proposals for action at shareholder assemblies, and the consequent way in which they vote. Where it can perhaps be differentiated from the other forms of responsible investment listed above is that effective engagement focuses on getting companies to change behaviour to act more responsibly.

How Newton defines responsible investing

At Newton, we believe that there are perhaps too many definitions of responsible investment, so our approach is to distil them into three broad buckets. That is not to say this is a definitive list, but it is one that, in our view, can demystify and break down the jargon often deployed in this sector.

Approach one: Exclusions and screening

The first bucket, exclusions and screening, is an investment approach that we have run since 1988 for some of our faith-based and charity investors. At the request of these clients, we can tailor portfolios to exclude entire sectors, for example armaments, tobacco or alcohol, or screen out individual companies.

Approach two: ESG integration

The second broad category is our ESG integration approach, which is the way that we manage the vast majority of our clients' assets (and has developed as part of the evolution of our investment approach since 1978). We were early adopters among our peers by expanding the investment universe in which we make active voting decisions and engage with companies.

Following our inception in 1978, we focused initially on domestic UK companies, but widened this in 2000 in order to ensure we were active stewards across all global companies. This practice continues and has evolved to entail our responsible investment analysts integrating ESG analysis before we commit our clients' monies to an investment opportunity. ESG considerations are also part of the fundamental analysis performed by our wider team of sector analysts. We believe that ESG considerations are an integral part of the fundamental analysis, as they affect a company's financial prospects.
In addition, we look to actively engage with the companies we invest in to help them improve their ESG profiles over time.

Approach three: Sustainable investing

Finally, the newest element of our responsible investment approach is what we term sustainable investing. Our sustainable strategies adopt the fundamental principles captured by our integrated ESG approach, and then amplify the responsible investment requirements. We use ESG analysis in order to positively identify companies with robust business models which effectively incorporate sustainability into their core business and strategy.

Our sustainable strategies aim to achieve their objectives through investing for the long term in securities of companies that positively manage the material impacts of their operations and products on the environment and society, as well as businesses with unrealised ESG-related opportunities.

Academic evidence

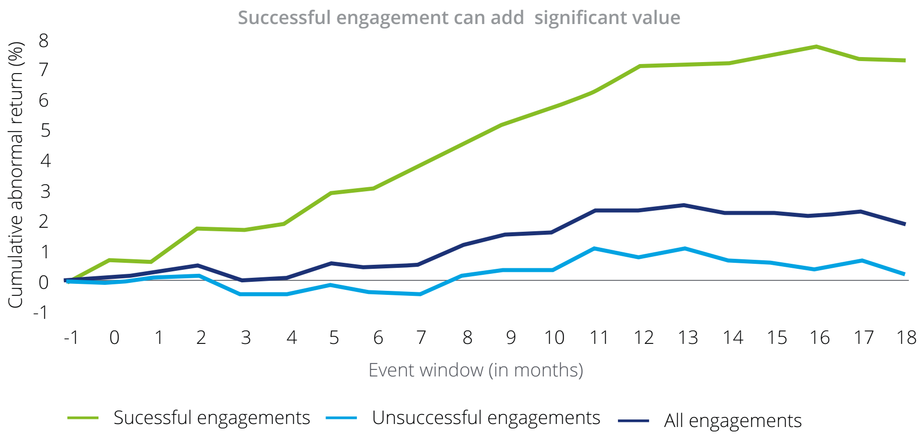
Finally, we look at some of the academic research around the positive impact that taking an active engagement approach to responsible investing can engender. At Newton, our approach to responsible investment is grounded in our belief that responsible investment is better investment, but there is a perception in some quarters that investing with a sustainable remit can mean giving up some of the investment return. However, there is a growing body of academic research which shows that, by focusing on actively engaging with companies on responsible and sustainable investment factors, returns can actually be enhanced. Newton has been a long-term supporter of the Centre for Endowment Asset Management at the University of Cambridge's Judge Business School, which has provided valuable data to back up this assertion.

The centre undertook an *Active Ownership*[7] study which examined examples of 2,152 engagement sequences at 613 US companies between 1999 and 2009. The rate of success was 18%, and it required an average of two to three engagements before success was achieved. Typically, the time between initial engagement and success being recorded was 18 months. Using ESG considerations, the 2,152 engagements were split into 1,252 environmental and social (ES) sequences and 900 corporate governance (G) sequences.

The results of the Active Ownership study revealed that successful ESG engagements can have a positive impact on returns, with very limited risk if an engagement in unsuccessful, illustrating the value of active engagement not just for society, but for firms and shareholders too. We discuss the study in more detail in an article around the findings,[8] but the chart below sets out the broad numbers, revealing that successful company engagements can often lead to better returns over the longer term.

Your capital may be at risk. The value of investments and the income from them can fall as well as rise and investors may not get back the original amount invested.

Cumulative abnormal returns after engagement
613 US companies 1999-2009



Source: Dimson, Li and Karakas (2015), Center for Endowment Asset Management. For illustrative purposes only.

Important information

This is a financial promotion. These opinions should not be construed as investment or any other advice and are subject to change. This document is for information purposes only. Any reference to a specific security, country or sector should not be construed as a recommendation to buy or sell investments in those countries or sectors. Please note that portfolio holdings and positioning are subject to change without notice and should not be construed as investment recommendations.

https://www2.deloitte.com/charities-and-not-for-profit.html

[7] Dimson, Li and Karakas (2015), Centre for Endowment Asset Management
[8] newtonim.com/uk-charities/insights/articles/active-ownership-does-it-work/

Notes

Notes

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