Being Good Stewards: Church Investors and Corporate Engagement

Church Investors Group

www.churchinvestorsgroup.org.uk

Welcome from Bill Seddon CIG Chair

Churches, from all denominations, were amongst the first institutional investors to identify the power of engaging with companies. Today, promoting responsible business practices in the companies our members invest in remains a key priority for the Church Investors Group (CIG). Over time our approach has become more sophisticated and significant progress has been made. Using some of the engagement techniques explained in this guide, collectively, we have been able to improve corporate environmental standards across the UK market as a whole. We have lifted environmental management standards, increased corporate reporting of greenhouse gas emissions, and encouraged the setting of emissions reduction targets amongst a high proportion of the UK's laggard companies. We are raising standards on an ever rising tide of best practice. We have also worked closely with individual companies to improve particularly poor practice or to help them meet major strategic challenges. As you will learn CIG members' engagement practices have incredible depth and breadth.

I have long said that church investors should be a 'witness' in the City of London and, whilst we were amongst the pioneers of engagement, one of the most heartening developments of the past few years has been the gradual growth in engagement conducted by investment managers and fellow asset owners across the City. As investors have increasingly recognised the long term threat to their investments posed by environmental, social, and governance concerns, there is a growing awareness of the importance of being active responsible owners. A small, but increasing, number are actively seeking to help companies plot a course to sustainable long term success in an increasingly resource constrained world. It is for this reason that I strongly welcomed the name of the UK Financial Reporting Council's Stewardship Code. Released as a response to the financial crisis, the Code aims to increase the quality of engagement between investors and companies as a method of protecting long term value. Stewardship is a word with a strong Christian heritage and it is appropriate for it to be used to promote active, and conscientious, ownership.

Of course stewardship means more to church investors than purely financial benefit. We have obligations to act as stewards of all of God's creations. That is why we think it is important to engage with businesses on issues that matter to the ecumenical church and our congregations but will not, necessarily, bring financial benefit. This is what makes us unique.

Whilst this Guide is about engagement with business we must not forget that this is not the only strand of our work. Our members also place emphasis on influencing public policy, particularly focussing on creating the right legislation for accelerating the transition to a low carbon economy. Once again the CIG must thank the Institutional Investors Group on Climate Change for its excellent work in this area.

I cannot finish this introduction without referring to the power of collaboration. The CIG exists to bring church investors together and, from my own experience, I have seen how powerful the Church can be when it speaks with one voice. As our investment portfolios have become increasingly global we have realised the importance of building links with international faith investor groups. Churches are amongst the few institutions that have a global presence that can face global challenges. By working together we can build a powerful investor network. However, CIG members do not exclusively collaborate with other faith investors. We seek to build the biggest and most effective coalitions possible to bring about the change we seek. Our collaborators differ from topic to topic but we are grateful to them all.

Finally, I want to thank our Secretary James Corah and CCLA for the efforts in writing this guide. I hope that you enjoy reading it and learning more about the work that we do. We look forward to updating you further as the CIG, and the businesses in which our members invest, enjoy even more productive engagement success.

Bill Seddon

What is Corporate Engagement and Why Do It?

Engagement refers to interactions between an investor and current or potential investee bodies (be they companies through for example equity investments, governments through gilts, or other assets through a variety of investment structures). Engagement with business, undertaken by investors, is predominantly conducted to influence, or learn more about, one or more areas of the investee company's practices.

CASE STUDY

Proxy Voting and Executive Remuneration

CIG members have devised a collective initiative that allows their members to lodge their votes in a manner that reflects their values. The main focus of this initiative is executive remuneration where they typically do not support two thirds of UK executive remuneration reports due to their belief that executive pay has, typically, become excessive.

The initiative also includes sustainability and diversity factors alongside promoting high standards of corporate governance. By working together these church investors have been able to aggregate the impact of their votes as they seek to change corporate practice across the UK market.

CIG members were amongst the most vocal investors in the run up to the, so called, 'shareholder spring' of 2012 where there were several high profile revolts against remuneration reports. Earlier in the summer CIG members had co-ordinated and co-signed letters in the press, alongside other investors, highlighting concerns regarding excessive executive pay.

CASE STUDY

Barclays

The Church of England Ethical Investment Advisory Group have led an extensive engagement with Barclays following the announcement that the Bank had been fined approximately £290m in June 2012 for seeking to manipulate LIBOR. Including meetings at Board level and submissions to the company's Salz Review into Barclays' Business Practices, the engagement, conducted alongside other CIG members, has helped shape their response to their ethical crises.

The motivations behind conducting such engagement take on two forms.

First, many investors conduct engagement as part of their approach to integrating environmental, social and governance factors into their investment process. This engagement is essential as it guides and shapes companies to help them make appropriate decisions about how to allocate their resources to develop sustained long term returns for shareholders. This has also been referred to as stewardship because investors, the company's part owners, seek to protect the value of their investments by stewarding, or guiding, the investee company through their long term challenges. This type of engagement is conducted by a broad range of investors, including asset owners (such as pension funds and charitable trusts) and their investment managers. As argued in investment consultant Towers Watson's 2012 report 'We Need a Bigger Boat, Sustainability in Investment', stewardship should be seen as a core part of any, sustainable, asset management mandate. As such the UK's Financial Reporting Council released the first version of its Stewardship Code in 2010 encouraging all investors to improve the quality of their dialogue with their investee companies. Furthermore, the most recent guidance from the Charity Commission is that all investors looking after charity assets should be 'engaging with company managements as a matter of course'. Engagement of this type is not ethical investment, although it comes naturally to, and has a strong overlap with, the priorities of many investors from that tradition. Instead, it should be conducted by investors of all types due to its concentration on preserving the value of investments.

The second form of engagement is an extension of an ethical screening policy. It is taking an organisation's concerns, be that a church's or charity's mission or the views of beneficiaries (such as those contributing to a pension fund), into the boardrooms of the companies invested in. This is a lesser used, but very powerful, approach. However, there are a number of misconceptions about this type of engagement.

Firstly, some see this activity as a form of campaigning and as being confrontational to the company. When done well this is not the case. By having more than a token shareholding in the company, investors are able to show clear alignment. Both organisations want the company to do well and develop profits, they just differ on one area of practice. This alignment allows for the development of trust and partnership and is one of the reasons why investor engagement is such a productive tool and should not be wasted on being purely adversarial.

Second, ethical investors, despite notable successes, do not seek, and are not able to alter, the core activity of a company. For instance, despite common concern, ethical investors do not try to persuade companies who derive a significant percentage of their revenue through the production of alcoholic beverages to cease this activity. Instead some, with investments in this area, have led productive engagement with these companies on their approach to marketing, ensuring that they do not promote the misuse of alcohol. As such engagement of this type must build upon appropriate ethical restrictions. Ethical investors restrict investment in companies that work in, what they consider to be, the most unacceptable areas or exhibit extremely poor practices, engagement must be used to change a second tier of concern.

Third, and finally, some see engagement as an excuse for ethical investors' fund managers to invest in companies that they should not. To avoid this any ethical investor, or their fund manager, should be able to tell you what it is they are hoping to achieve by an engagement and details of progress made. Several ethical investors go one step further and, after time, divest from a company if they are not willing to respond to engagement.

Engagement Techniques

Engagements normally take one of three forms. The first is stewardship monitoring, where investors routinely monitor developments at all of the companies in their portfolios and regularly meet with a subset of investee companies. Engagement of this type allows the company and investor to have a thorough knowledge of each other and any ethical, or other, concerns that either may have. It also allows for the tracking of progress over time. As part owners of businesses investors should 'know what they own' and stewardship of this type is a part of doing so. Second, there is 'lifting all boats' engagement. This aims to raise the standards of all companies (be that in a market or particular sector) on a rising tide. It is used to improve issues on a collective basis, often relating to systematic or structural problems, when there are a number of companies showing the same problematic behaviours. Finally, there is 'heavy lifting' engagement. This aims to increase the standards at one, or a small number of companies, where particular issues have been identified. Increasingly sophisticated engagers are divesting from companies that do not show willingness to change after persistent engagement.

CASE STUDY

Global Collaboration Retail supply chains & Bangladesh

The collapse of the Rana Plaza building in Bangladesh with heavy loss of life was shocking and concerning. The specific cause of the disaster was poor construction, but it highlighted longstanding concerns about the apparel supply chain. Many UK and European retailers signed the Accord on Fire and Building Safety in Bangladesh. This committed the apparel industry to a legally binding framework of independent inspection and improvement of factory premises. Globally, faith investors have worked with apparel manufacturers to encourage them to adopt the framework with our US based collaborators, the Interfaith Center for Corporate Responsibility, organising an international letter co-signed by investors with collective investment assets of over $3tn. In the UK the Central Finance Board of the Methodist Church engaged with Primark (owned by Associated British Foods), which had contracts with suppliers in the building to learn more fully how it audits and assesses overseas suppliers for poor or dangerous working practices and how it promotes better standards. Primark have signed the Accord and was also the first retailer to offer compensation to those affected by the collapse, and put in place emergency relief at the time of the tragedy.

CASE STUDY

Attending AGMs to Encourage Companies to 'Aim for A'

Coordinated by CCLA "Aiming for A" brings together a coalition of investors including mutuals in the UK fund management industry and influential UK asset owners, incorporating the £115bn Local Authority Pension Fund Forum and the largest members of the Church Investors Group. The 'Aiming for A' coalition is asking ten major UK-listed utilities and extractives companies to aim for continuous inclusion in CDP's Climate Performance Leadership Index (CPLI) by achieving and retaining an "A" Performance Band. As part of this engagement CIG Steering Group member Helen Wildsmith, who represents the CBF Church of England Funds, attended the BHP Billiton AGM as a method of escalating the engagement following the company slipping down the Carbon Disclosure Project's (CDP's) Climate Performance Leadership Index. 'Aiming for A' is a multi-year initiative and participating CIG members see it as a critical part of their role in exercising their ownership rights to steward companies through the anticipated transition to a low carbon economy.

Given these three different approaches to engagement there are a number of different techniques that are used when working with companies:

Engagement technique	Description	Rationale
Proxy voting	In the vast majority of cases shareholdings permit investors to vote on the resolutions put to companies' Annual General Meeting. This gives the shareholders the ability to vote on the election of directors, the executive remuneration package, and any proposals placed by other shareholders by way of example.	Proxy voting is a relatively time efficient method of engagement. The ability to place votes means that it is easy to engage with many companies irrespective of geographical location. Voting can be linked to wider concerns, with votes issued in a way to indicate particular issues.
Letter based engagement	Investors can write to companies asking for them to provide information or implement improvements in a particular area of activity.	Letters are an efficient way of engaging with a large number of companies. It is a cost effective way of conducting 'lifting all boats' engagement by asking many companies to improve their practices in a particular area.
Meetings	Investors can ask to meet with companies to discuss areas that cause them issues. This practice is normally reserved for larger investors but smaller investors are able to collaborate with other likeminded investors through organisations such as the Church Investors Group or mandate their fund manager to engage on their behalf.	Face to face meetings are an effective way of generating trust between the investor and company. It allows the development of a mutual understanding on a topic and, over time, progress to be made. Due to being time intensive this practice is usually reserved for 'heavy lifting' engagements, however some investors do use meetings as a method of conducting 'stewardship monitoring'.
Annual General Meeting attendance	Investors are permitted to attend company AGMs and ask questions of the board of directors on any issue.	This is a high profile strategy due to the public nature of the meeting. The tactic is usually the preserve of NGOs and smaller investors who do not benefit from the ability to conduct other methods of engagement. Institutional investors rarely ask questions at AGMs, when they do so it is normally a method of escalating an ongoing 'heavy lifting' engagement.
Divestment	Should investor engagement fail to engender the progress required investors can use, what is often the ultimate step, and divest from the company by selling their holdings.	Although only used as a last resort, following exhausting all possible other modes of engagement, divestment is a final manner through which it is possible to generate progress at a particular investee company. This usually follows a prolonged attempt at conducting a 'heavy lifting' engagement. Following divestment the investor will no longer have a voice at the company as the alignment caused by ownership will have ceased to exist. However divestment by some can help those investors who are continuing to engage.

The Church Investors Group Approach

Church groups, and people of faith, were amongst the first investors to use their shareholder rights to actively engage for change. For instance members of our international partner, the Interfaith Center for Corporate Responsibility (ICCR), were the first to file a shareholder resolution on a social issue at a company AGM. Building on this legacy several CIG members remain amongst the most engaged ethical investors in the world.

In addition to a commitment and support for the collaborative activities conducted by the CIG on behalf of all of our members, church investors conduct engagement in a further two ways.

Some of our members are in the fortunate position to be large enough to have their own dedicated ethical investment teams who conduct engagement on their behalf. These organisations, through a resource sharing agreement, also collaborate with each other on behalf of the rest of the group to ensure that their resources are spread as widely as possible.

The majority of our members, who are not large enough to have their own engagement teams, rely upon their fund manager to conduct corporate engagement on their behalf. However, rather than being a tangential activity, many of these actively incorporate manager's engagement activity into their selection criteria when appointing them to manage their assets.

No matter how engagement is conducted CIG members recognise the importance, and power, of collaboration.

CASE STUDY

Raising Environmental Standards Throughout the UK Market

In 2013, the CIG continued its longstanding engagement programme of encouraging companies who operate in carbon intensive sectors, or that could be considered to be laggards in comparison to their peers, to report their greenhouse gas emissions to the Carbon Disclosure Project (CDP) and to adopt emissions reduction measures. To enable engagement across the whole of the market the initiative was based upon sending tailored letters to the targeted companies. The program resulted in a 72% improvement in the performance of the 53 companies targeted and academic assessment of the initiative showed with a 90% confidence rate that CIG members were responsible for the improvement amongst FTSE250 companies. We look forward to seeing further substantial progress in, and beyond, the UK market in 2014.

CASE STUDY

Divestment and Vedanta Resources

The Church of England's Ethical Investment Advisory Group (EIAG) engaged with Vedanta Resources about its Lanjigarh refinery and proposed bauxite mine in the Niyamgiri hills of Orissa, a sacred site for the indigenous population. Despite intensive engagement attempts, including a visit to the area, progress was not achieved and, consequently, the EIAG recommended divestment to the Church's National Investing Bodies. Following the disinvestment in February 2010, Vedanta was denied permission to expand the controversial refinery and go ahead with the mine, appointed a Chief Sustainability Officer, and accepted the comprehensive recommendations of an independent sustainability review. The EIAG continues to engage with the company on the further progress they need to make before it would consider reviewing its disinvestment recommendation.

The CIG recognises that, with increasingly international investment portfolios, an international response is required to the many global issues we face. To this end we are working hard to create an international network of faith investors who are able to bring the benefit of local knowledge and leverage other faith investor's assets in their engagement with companies in their own locale. However, CIG members also seek to build the largest and the most appropriate engagement coalitions to bring about the required change in corporate behaviour. As such our partners vary considerably throughout the different strands of our work. As a consequence CIG members do not exclusively work with other faith investors. On shared issues, such as promoting long term behaviour in investee companies, we work with the wider, growing, responsible investment movement. By way of example, many of our members have joined the Institutional Investors Group on Climate Change and actively participate in their work streams. Similarly, several Church Investors have signed up to the United Nations backed Principles of Responsible Investment and often collaborate with other signatories.

The CIG, and its members, use many of the engagement techniques identified in this guide to preserve both the long term value of their investments and to reflect the views of the wider church.

The CIG secretariat is provided by

CCLA

Further information is available on the website **www.churchinvestorsgroup.org.uk**
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