How the Joseph Rowntree Charitable Trust divested from fossil fuels

Based on the experience of Jackie Turpin *and her charity, divesting from coal, oil and gas stocks need not have a negative effect on investment returns.*

Jackie Turpin *is head of finance at the Joseph Rowntree Charitable Trust*

THE JOSEPH Rowntree Charitable Trust has never shied away from difficult decisions, and in 2013 the trustees realised that it was time to make another. Despite investment orthodoxy suggesting it was madness not to invest in coal, oil and gas stocks, the trustees felt that the potential contribution of these companies to climate change was so devastating that they had no option but to divest from fossil fuel extractive companies.

From their grantees' work, including that of the Carbon Tracker Initiative, they knew that if all the reserves of coal, oil and gas that sit in these companies' balance sheets were to be burnt, it would be nigh on impossible to keep global temperatures within sustainable limits. The commitment they made was to achieve divestment by 2020.

MEETING THE COMMITMENT AHEAD OF TIME

Having taken this decision, the Trust became the first UK foundation to sign up to the Divest Invest Philanthropy Pledge. Divest Invest Philanthropy is a group of over 150 foundations worldwide which are divesting from fossil fuel extractive companies' stocks and switching to clean energy investments, joining pension funds, universities and faith groups that are doing the same.

In fact, as a result of maintaining a clear vision and careful portfolio management, the Trust was able to achieve its goal three years ahead of time, in early 2017. The trustees didn't feel that it was appropriate to celebrate because it was simply something that they were called on to do. But they did have a sense of a job well done.

> "Companies have known about the situation for years now"

LUCK OR JUDGEMENT?

Many investors considered this to have been a brave, principled stance to have taken, even if it was not one that, because of the fear of loss of financial returns, they would have been willing to take themselves. While they respected the Trust's positioning, as laid out in its investment strategy, that the trustees will not allow financial returns to be their sole consideration when making investment decisions, this was not a choice they would have made.

But actually the Trust has achieved excellent returns since adopting this position and has improved its long-term performance. So has this simply been a case of luck, or is there more to it? Could it be that the Trust's fundamental approach to investment, investing in funds which seek out companies which behave responsibly and aim to be sustainable in the long term, is actually a winner? Might it be that a decision "to do the right thing" can also equate to good financial decision making?

FINANCIAL RISK

There is a misconception among many charity investors that if they attempt to align their investments with the values and aims of their organisation, this will be to the detriment of their financial returns. They believe that unless they are able to diversify widely to maximise returns and reduce risk, their capacity to deliver directly against their mission will be compromised.

However, this viewpoint really depends on how you look at financial risk. What is the real risk here? Is it that a portfolio is not diversified as widely as possible? Or is it that at some point in the not too distant future someone is going to invent a battery pack which has the capability of storing industrial amounts of renewably generated energy, deeming fossil fuels redundant? We already know that renewables are taking an increasing share of the energy market.

FLEET OF FOOT?

While many commentators would perhaps accept this scenario in the long term, they would argue that over the short term there is not a problem – all that is required is an eye on the ball and good market timing.

But in actual fact, how many charities and their fund managers really invest for the short term? In reality, most charities and their fund managers, recognising the risks of speculative investing and

the challenges of dealing with its downside, choose to invest for the long term. So if these charities have stocks of fossil fuel extractive companies in their portfolio, it is much more likely to be the result of the search for diversification or reduced volatility by a degree of index tracking rather than any attempt to seek out short-term gains.

AN EVEN GREATER RISK

Of course there is an even greater risk beyond the financial risk associated with fossil fuel investment – that by pouring more and more money into these companies to finance their development plans, we fail to respond to the UN's 2015 Paris agreement and its unequivocal call to limit global temperature increases to below 2°C. If as a society we fail to meet this target, not only should we expect the benefits of our work to unravel but we should also anticipate unimaginably horrific consequences for our beneficiaries and other stakeholders.

Some responsible investors would argue that you can have your cake and eat it, and that the most effective course of action is to engage with extractors of fossil fuels. However, while my trustees accept that engagement on climate risk is a relevant strategy for decarbonisation outside the fossil fuels extractives industry, evidence belies the suggestion that it will lead to material change within the industry itself.

The reality is that these companies have known about the situation for years now and have done very little in the way of taking ameliorating action. Why not? Because their financial sustainability is inextricably linked to their ability to exploit their fossil fuel reserves. They simply cannot afford not to keep relentlessly pushing forward with their plans because, if they don't, their balance sheets will collapse.

AN ALTERNATIVE APPROACH

While there may be a strong argument for divesting from the stocks of fossil fuel extractive companies, the notion of divesting from all "sin" stocks and moving to a position of investing in companies that reflect their own values does feel very extreme to some charity investors. But a different way of looking at it is to consider this question: "Which companies are going to be the ones that both survive and outperform in the long term?" Simple logic would suggest that it will be those that operate with integrity, are respectful of their stakeholders and the environment, and are mindful of future sustainability.

This is certainly the viewpoint that the Trust has held for a long time. For many years, the Trust was at the forefront of the development of ethical investment, and implemented negative and positive screening through a segregated mandate. However, in 2013, the trustees decided to transfer the management of the Trust's main portfolio to fund managers who run sustainable pooled funds. This strategic move reflected their appreciation of the growing expertise on responsible investment within the investment industry.

> "We've outperformed our composite benchmark"

THE RIGHT FUND MANAGERS

Finding the right fund managers, especially ones who genuinely integrate environmental, social and governance issues into their routine investment processes, took a lot of time and research. The trustees wanted to invest through funds, and they were clear that they wanted fund managers that they could rely on to invest in the right way and who did not need to be micro-managed.

But when they did find the right ones, it was reassuring, although not surprising, to find that investment in fossil fuel extractive companies was not an issue. As sustainable fund managers, they do not see a future in these types of stocks and simply do not invest in them.

VIRTUE REWARDED

The Trust's transition to its new managers and its divestment from fossil fuel extractive companies coincided. Prior to the switch, the Trust had been through a period of relatively poor financial performance. However since 2013 it has outperformed its composite benchmark of the FTSE All Share Index and the MSCI World Index, weighted to reflect the relative proportions of UK and global stocks in the portfolio, by 2.7 per cent per annum after fees. On funds invested in this way of £233m at the 2017 year end, this represents over £6m. Importantly, the outperformance has been consistently good over the period.

Of course it is still early days for the new arrangements. But what is clear is that fossil fuel extractive divestment has not been a dampener on returns.

Even if fossil fuel divestment had had an impact on the Trust's financial performance, the trustees would have still gone ahead with it because, when faced with the greatest threat of our time, they were not prepared to do nothing. But the conclusion to be drawn from this is that doing the right thing brings not only societal but also financial rewards, which makes a compelling argument for responsible investment. ●

Five ingredients for making responsible investment pay

1. Embrace a long-term investment perspective, adjusting reporting time horizons to reflect this.
2. Be clear about the characteristics you value in the companies in which you invest.
3. Employ fund managers who think like you, and demonstrably integrate environmental, social and governance issues into their stock selection. Make sure that they walk the talk.
4. Keep communicating your values and concerns to your fund managers, and make them work for you.
5. Hold your fund managers to account.