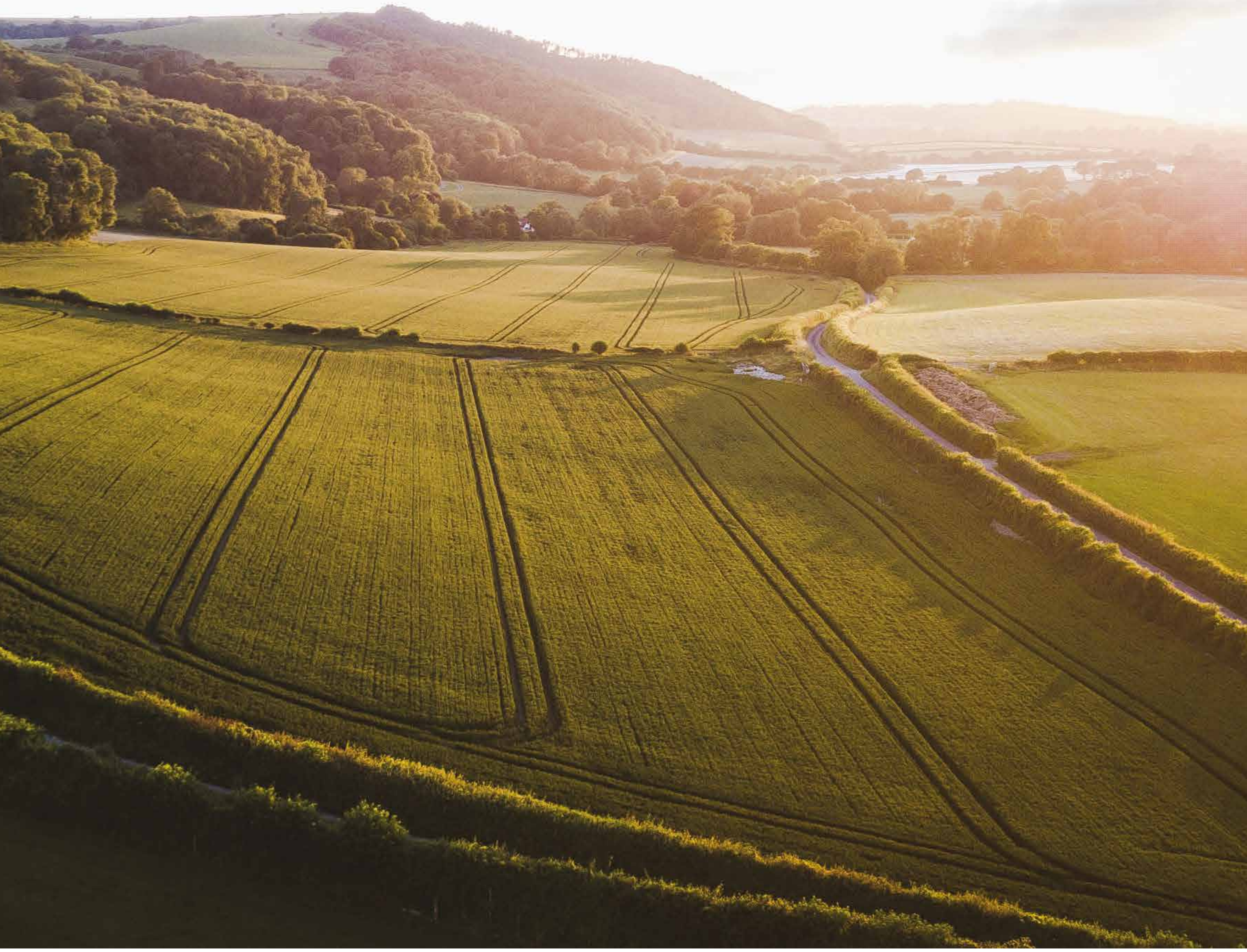
CASE STUDY

Esmée Fairbairn Foundation



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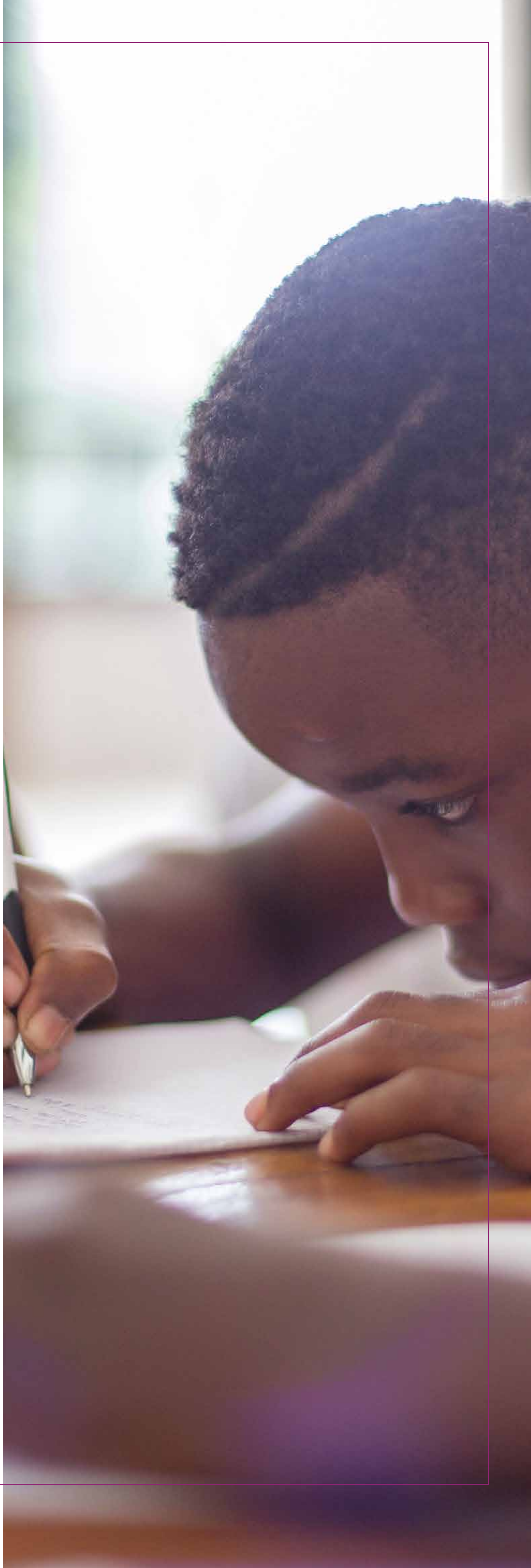
Esmée Fairbairn Foundation

Investing with impact in the endowment

Our vision at the Impact Investing Institute is for capital markets that are fairer and work better for people and the planet. We see impact-driven investment by charitable endowments as integral to that transformation. With support from the Department of Digital, Culture, Media and Sport and Esmée Fairbairn Foundation we have created materials, including this case study, to support charitable endowments as they consider this approach to investing and seek inspiration to get started.

For the Impact Investing Institute, impact investments are investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return. Investments can be across asset classes, in both emerging and developed markets, and target a range of returns from below-market to market-rate, depending on the investors' strategic goals.

When discussing charitable endowment investments specifically, investors are often focused on risk-adjusted market rate return opportunities. The Association of Charitable Foundations terms this sub-category as "impact-driven" investing: in the US this approach is referred to as Mission Related Investing.
As this is an emerging field of practice and there are no mandated definitions of impact, many impact investors use different terminology to refer to similar concepts. Where possible in the case study below we have attempted to clarify the definition in use.



Founded in 1961, Esmée Fairbairn Foundation is one of the UK's largest independent grant-making organisations, with an endowment of £1.172 billion[1] a typical active portfolio of over 900 grants and a £45 million social investment fund. It has three main aims: improve our natural world, secure a fairer future and nurture creative, confident communities.

Dame Caroline Mason, chief executive officer, spoke about transitioning the endowment's investment portfolio towards impact investing.

What stage is the foundation at in its impact investment journey?

As at late-2021, we're just starting a complete review of our investment strategy. We've been trialling environmental, social and governance (ESG) for a few years and have recently started looking at impact investing. But we realised we had to go right back to basics if we were going to make responsible investment – as we prefer to call it – genuinely central to the endowment. So now we are looking to rewrite our trustee mandate, our Investment Policy Statement (IPS) and review our investment strategy.

How do you look at impact holistically across your operations?

Our view is that we have our impact goals and we have tools across the board that we can use to further that impact and catalyse change. In terms of money, we can use the full spectrum of capital from pure grants all the way through to impact investment targeting a market-rate return.

Alongside that is our role as a convenor and catalyst so, cross-sector, we bring together what we call unusual alliances to focus on a particular problem. That might involve grant money or include investment. Finally, we see ourselves as an asset owner so we also view influence as a tool. We are always thinking about what combination of tools we can use to have the maximum impact.

1 As at end-2020

Do you have a specific carve-out to focus on impact investment?

We have pockets of capital that we've been using to test things. That includes a specific carve-out from our mainstream investment portfolio of £25 million, which has a primary objective to achieve financial returns in line with our mainstream investment strategy (i.e. RPI + 4%) and deliver enhanced environmental, social and governance (ESG) impact.

We have been investing in ESG funds within our endowment for some time now but the carve-out was a specific way for us to identify funds at an earlier stage of their life-cycle that are trying to be more innovative in their approach.

We also have £10 million that we are using to experiment with impact investing opportunities, and to test the potential for achieving financial returns by investing into impact funds that align to our impact goals. Finally, we have our £45 million allocation to social investments, which prioritise the creation of impact, accepting concessionary returns as a consequence. Now we want to consider how we can further transform our endowment for the creation of good.

Our aim is to transition our endowment over the next few years towards Net-Zero and responsible investing.

What was the journey to taking this approach?

Like many foundation endowments, it has taken time to move from a very traditional model that did not embrace any form of impact; even in the form of exclusions. Everything was totally delegated to the investment committee and our investment advisers had never presented to the full board.

As with other foundations, a significant amount of work was needed to take trustees to a place where they were well informed and comfortable with the risks and opportunities associated with responsible investing. The process we went through involved adding information to board papers and working with our advisers, Cambridge Associates, to develop an ESG strategy. That led to us creating the initial enhanced ESG carve-out of £25 million in 2016/2017.

We also asked our adviser Cambridge Associates to speak to each of our trustees which was really, really helpful. Two years ago, Cambridge Associates presented our trustees with their views on climate risk and made it clear that if we were not thinking about climate change as part of our long term investments strategy, then we were being negligent. This led to our work on setting a Net Zero strategy.

The trial £25 million carve-out has been a successful initiative so, in 2020, we developed an approach where new funds into the endowment were ESG aligned. We are now looking at revising the mandate from the board to the investment committee to transition to responsible investing. This will involve looking at three principles. The first is to identify and move away from investments that we believe have no future. Secondly, identify investments that are transitioning and helping them to do that. Thirdly, identify areas where we see opportunities emerging for positive change such as farming, clean water, soil health and the circular economy.

Has the structure of the team evolved to accommodate this new approach?

We now have much more engagement from our full trustee board. We have also had changes in our investment committee and have recruited two new co-opted members; an ESG specialist and a venture specialist. We are reviewing our mandate as well as our investment policy statement and overall strategy.

How do the grant-making and investment teams work together?

We have investment expertise sitting alongside our grant-making team. So the social and impact investment team can bring finance and investment structuring expertise, which is complemented by our grant team's knowledge in our impact areas – for example, in water or farming – and submit a joint recommendation. We want to trial this approach with our investment advisers for our mainstream investments. So any recommendation on impact comes from both us and our investment advisers.

How are you balancing the need for risk-adjusted return?

We don't think in terms of only risk-adjusted returns. For us the focus has to be on understanding what outcomes we want over the long term and then working backwards to design the right structures and find the right investments to achieve them. So the next step for our endowment will be to explore models where outcomes rather than investment structure come first. That will involve trying to find people who are willing to look at solutions that aren't the classic fund structure – which is very exciting.

How do you measure impact?

We don't do it because we think it's the wrong question! We track progress and set progress indicators. But it's not about proving – it's about improving and making sure we're doing the right thing with the right people in the right place. We're talking about problems that are deeply complex, systemic and engrained in our society, so we take a long-term view and understand that quarterly or six-monthly updates are unhelpful in this context. Nor do we believe in attribution: the impact isn't ours – we're just facilitators of other people's impact.

Have there been any organisations that have inspired or helped you on this journey?

We've been inspired by Client Earth, ShareAction and the Carbon Disclosure Project, who are respectively using the law, shareholder activism and data to shift the market. We learn lot from them about what's happening and who is doing what. So that's really helpful in terms of how and where we invest.

We're also inspired by foundations like the Heron Foundation, which has done extraordinary things and been well ahead of its time. Finally, we get inspired by the people we work with who are challenging traditional investment practices in areas such as climate change and who really understand these issues in a way that the mainstream investment industry doesn't.

What would you say to other foundations who are hesitating to step into this space?

I would say allocate a small piece of your endowment with a specific set of conditions and give it a go. As soon as you start the journey, all those fears about the risks associated with impact investing start to become manageable.

To help other foundations, we and the Environmental Funders' Network are trialling a peer learning group around social investing.[2] The aim is to focus on practicalities such as the process of sourcing and due diligencing investments and to encourage others to take that first step into this space, as well as growing the amount of finance delivering positive outcomes.

2 https://esmeefairbairn.org.uk/latest-news/environmental-finance-and-learning-fund/