Investment Policy Statement

1. Introduction

This Investment Policy Statement (IPS) is agreed by the Trustees of Esmee Fairbairn Foundation (the 'Foundation') on the recommendation of the Investment Committee (the 'Committee') and provides a framework for how the foundation manages its investment portfolio. It establishes Investment Objectives in line with the Investment Committee Terms of Reference of the Foundation (as set by the Board of Trustees), policy asset allocation, rebalancing criteria and investment restrictions. The IPS should act as the common reference point for material investment decisions affecting the portfolio. Material investment decisions affecting the portfolio should also be increasingly aligned with the Foundation's strategy and values. The IPS is meant to be a long-term strategic document and will remain in effect unless altered by the Committee and approved by the Board of Trustees.

2. Governance, Roles & Responsibilities

The portfolio is overseen by the Investment Committee working in partnership with its investment advisor. The details of the roles and responsibilities of the Investment Committee, the Board of Trustees, and the investment advisor are included within the Investment Committee Terms of Reference dated December 2022.

The Foundation deploys money across the spectrum of capital and has a range of approaches for allocating capital, each with their own different financial and impact goals. These include grant-giving, our social investment fund, our impact investments and our main investment portfolio. This IPS outlines the approach taken by the Investment Committee in managing the main investment portfolio.

3. Investment Objectives

Objective 1: Financial Return Target

The long-term return objective for the investment portfolio is RPI+4% (net of investment management and oversight fees) annualized over rolling ten-year periods.

While the investment portfolio is technically expendable, the Foundation wishes to behave as a permanent institution and has adopted investment and funding objectives consistent with the aim of maintaining the real value of the portfolio. The strategic spending and return objectives are incorporated within the IC Terms of Reference which is reviewed periodically by the board.

The funding policy determines the annual amount of funds which can be withdrawn from the portfolio and made available for distribution each year. The currently agreed spending rate is 4.25% which is applied to the average portfolio value over the previous five years. The Board is responsible for the review of the funding strategy and approval of spending amounts and takes advice on this annually from the Finance & Administration Committee.

Objective 2: Focus on sustainability

The foundation will take sustainability considerations into account whenever making a decision in the investment portfolio.

Activities that cannot be sustained environmentally or socially naturally give rise to risks and these may be financially material. Our approach aims both to avoid those risks and to capitalize on long term opportunities through a good understanding of how material sustainability issues impact our portfolio and our investment opportunities.

4. Alignment

We would like our investment portfolio, where possible, to be increasingly aligned with our foundation's overall strategy and values. This means minimising our exposure to investments likely to produce conflicts with our priority areas as well as seeking out ones where there is good alignment, for example in the area of climate solutions.

We aim for our fund manager selection to be driven primarily by identifying positive characteristics rather than avoiding negatives. Nevertheless, we look to avoid investing in funds with these characteristics:

- Funds with high exposure to long-lived fossil fuel production, especially exploration for new reserves, unless there is a truly credible path to net zero.
- Funds with a significant proportion of holdings that are heavy CO2 emitters with inadequate net zero transition plans and when there is no credible and robust engagement process likely to improve those transition plans
- Funds with significant holdings contributing to biodiversity loss, again where there is no credible and robust engagement process.
- Funds with holdings classified as breaches of the UN Global Compact. (The Compact is a series of sustainable and social responsible policies covering human rights, labour, anti-corruption and the environment.)

Areas where there is likely to be good alignment with our strategy include renewable energy, biodiversity preservation and restoration, decarbonisation, social justice and thematic funds focusing on water, food and communities. We aim to make steady improvements on alignment each year and make use of any learning from other parts of the Foundation, such as our social and impact investment team. We aim to build constructive, long-term partnerships with those who are managing our capital.

5. About Esmée

Our strategy

The Foundation's 2020-2027 strategy focuses on three areas: We aim to improve our natural world, secure a fairer future, and strengthen the bonds in communities in the UK. We do this by contributing everything we can to unlock change by people and organisations with brilliant ideas who share our goals.

Within the "Our Natural World" priority, we want to ensure that our natural world is restored and protected and that people benefit from that recovery. Working with others, we will contribute to three key impact goals: preserved and improved species health and habitats, clean and healthy freshwater, and sustainable and ethical food. Underpinning these, we will look to support high-integrity, nature-based financing and investment solutions.

For our focus on "A Fairer Future", we want to contribute to a socially just and anti-racist society, where people have their rights protected, as well as the opportunity to speak and be heard, and the freedom to express their creativity. And across all our work in A Fairer Future, we are keen to support organisations led by the people they serve. As part of this we are using our social investment to tackle systemic injustice and inequity, looking at early years and young people, justice, and art and creativity.

Our work on "Creative, Confident Communities" aims to strengthen the bonds in communities, helping local people to build vibrant, confident places where they can fulfil their creative, human and economic potential. Places where the local economy works better for the people who live there, where there is equality of access to arts and culture, and where communities are at the heart of change. As part of this we are using our social investment for place-based investments that are led by the community and doing this through partnerships.

Climate change and DEI (Diversity, Equity, and Inclusion) underpin our strategy and we factor them into our decision making across all three impact areas. We have made a commitment for the investment portfolio to be Net Zero by 2040 or sooner and we support initiatives which aim to increase alignment between the investment services industry and the Paris climate change accord. We would like our portfolio to become nature positive over time and support the adoption of best-in-class standards and metrics that enable investors to do this.

Our values

Our five organisational values act as a guide for staff and Trustees about how we work at our organisation. They are a frame of reference for how we take actions and make decisions:

- **Equity** – by this we mean striving for fair opportunities and outcomes for the people we work with, and endeavouring to understand and respond to their contexts, cultures, and characteristics.
- **Kindness** - we show empathy and consideration in how we treat people and treat each other. We recognise that people are at the heart of what we do.
- **Integrity** – we are honest and holding ourselves to the highest standards of behaviour. We are clear and straightforward in our relationships and in our communications, and accountable for our actions and their effect on others.
- **Ambition** – we use the opportunity given to us by our investment assets to be bold and proactive, to take risks and ask questions. We encourage independent thinking, we learn and adapt, and we always ask ourselves "what more could we do?"
- **Working together** - we focus on generous collaboration where all partners' resources, skills, lived experience and expertise are valued. We recognise that working alone limits what we can achieve.

6. Guiding Principles

The approach to allocating capital and prioritizing investment decisions is underpinned by the following investment beliefs and guiding principles.

We see sustainable investing as a potential competitive investment advantage

The Foundation seeks to achieve a fairer future for people and nature. We believe that sustainability is increasingly material to investing, particularly for long-term organisations. Investing through a sustainability lens across the total portfolio may be a competitive advantage in both identifying new opportunities (the economic growth from positive change) and avoiding risks of permanent impairment of capital (the cost of unsustainable business practices).

It can also contribute to and align with the Foundation's overall mission. Esmée seeks to partner with investment managers that take a market-leading approach to sustainability, and trusts them to make company specific sustainability and engagement decisions that are in line with our commitments to a fairer future.

We invest in solutions and seek real-world outcomes

We take a multifaceted approach to sustainability that emphasizes tangible, real world outcomes over simply making the portfolio "look-good" on an ESG score. For investments in existing capital, like public equity, this means evaluating managers according to how they work with companies to improve their behavior, including setting measurable Net Zero objectives. For private investments, this includes providing new capital to emerging/innovative businesses that can create positive social or environmental solutions and outcomes.

We are willing to be proactive, early, different, and catalytic

The Foundation is a long-term independent investor willing to be different from the crowd in areas where it has the knowledge and experience. We therefore use the advantage of our long-time horizon by investing in complex, illiquid, or nascent strategies that are not available to investors with a shorter horizon or a greater focus on managing short term benchmark risk. We also seek to be ahead of the curve in identifying emerging sustainable investment opportunities across the entire portfolio and enhance these efforts with the Sustainability and Impact allocations.

We focus on longer-term risks

The Foundation defines its principle risk as failing to ensure consistent funding of the Foundation's mission for decades to come (by preserving the real value after spending). The investment portfolio is exposed to both uncertainty – no-one knows what the best investments will be over the next 20 years – and to volatility – shorter term fluctuations in asset values. However, volatility is only a threat to preserving value if Esmee becomes a forced seller of assets at unfavourable prices.

We require transparency

The Foundation is aware that its mission or its credibility may be undermined if it invests in businesses whose activities undermine its values and impact objectives. The Foundation will seek to avoid narrowly focused strategies which may have meaningful exposure to such controversial areas. Given this, transparency is very important in identifying where conflicts may arise and in facilitating engagement efforts that can lead to positive change where possible.

We aim to engage effectively

The Foundation is willing to engage with businesses and asset managers to align outcomes with its strategic priorities and its move to sustainable investment but will avoid excess complexity or devaluing its impact by untargeted, unrealistic or numerous initiatives.

7. Risk

Primary risks

We seek to manage five key financial risks:

1. **Failing to earn enough return** will limit the portfolio's ability to support funding over the longer term and hence the majority of the portfolio is invested in equity or equity like assets to ensure these returns.
2. **Environmental and sustainability risks** can negatively impact both the broad economy as well as our investments. We recognize that some risks like climate change and biodiversity loss are systemic and cannot simply be diversified away. We address these issues by partnering with managers that integrate sustainability and engagement into their investment process and investments. We also require high levels of portfolio transparency from our managers to allow us to monitor and engage on environmental and social issues that have material impact.
3. **Forced disposal of assets at distressed prices** in an adverse market environment may result in permanent impairment. Hence a portion of the portfolio will be held in a low risk 'cash reserve' which may be drawn down to support funding.
4. **Excessive concentration in a single asset or active manager strategy** also raises the threat of permanent impairment hence assets will be diversified across a number of underlying third -party investment managers. Capital allocations to managers are sized based on an assessment of risk, with higher risk, less liquid funds sized smaller and lower risk, more liquid funds sized higher. Details of the investment manager limits are shown in the Addendum.
5. **Inflation** may erode purchasing power over the longer term and hence the majority of the portfolio will be invested in 'real' assets (such as equities or property) with a link to prices in the real economy.

Reputational issues

These are considerations where they might lead to restrictions in the way we operate, for example by impacting our relationships with organisations we fund or by making it harder to work with other charitable foundations. We mitigate these risks by monitoring our holdings and understanding areas of possible conflict with our funding work.

Volatility tolerance

As noted in the Guiding Principles section, volatility is not the Foundation's primary risk as the portfolio can tolerate day-to-day or year-to-year fluctuation in asset values driven by how the market chooses to price them. The Foundation does not wish to take unanticipated risk, however, so for monitoring purposes, it has agreed a simple market volatility benchmark comprised of 70% Equities and 30% Bonds against which to judge whether the investment performance is within the expected range given risks taken and the market environment.

Risk monitoring

The portfolio's quantitative risk limits and guidelines are depicted in the Addendum. Alignment with these measures is depicted in a traffic light summary exhibit in the quarterly Investment Committee materials.

8. Asset Allocation

The portfolio's asset allocation should reflect the Foundation's long-term investment objectives including the need for liquidity, preservation of purchasing power, and risk tolerance. To achieve its long-term investment objectives, the portfolio shall be allocated among three main asset categories, defined by their role in the portfolio.

- **Return Drivers –** to support funding needs while maintaining the portfolio's real value over the long term. The category may include a wide variety of asset classes and strategies which prioritise returns over risk in both public and private markets. We expect strategies included in this category to aim for equity-like returns or higher.
- **Diversifiers** – to improve the risk/reward profile by providing additional sources of return that are less tied to the equity market cycle. This may include a wide variety of asset classes and strategies which prioritise diversification of risk (especially equity and credit-related) over returns. Liquid and illiquid assets may be held.
- **Cash Reserve** – to provide liquidity as needed to fund the Foundation's activities and capital commitments. This should be primarily comprised of cash instruments and liquid, fixed income securities with minimal credit risk, principally government bonds.

The long-term strategic targets and acceptable ranges are shown in the addendum to this IPS. Although it is useful to consider the asset allocation in terms of precise targets, it is important to note that the actual portfolio will be managed within wider ranges to accommodate normal portfolio drift as well as tactical considerations.

9. Implementation

Use of third-party managers

The Committee has chosen to delegate day-to-day management of the assets of Esmée to third-party fund managers. We invest through pooled funds, segregated accounts or partnerships investing in marketable alternative strategies (e.g. arbitrage, long/short equity, and distressed securities), private equity, venture capital, natural resources, commodities, property, etc.

Given the Foundation's sustainability lens, third party managers are expected to demonstrate characteristics of a well aligned, long term partner. This includes having a high level of portfolio transparency, proactive engagement with the underlying investments, and taking a forward-looking approach to identifying material sustainability issues relevant to their investment opportunity set. Note that depending on the asset class or strategy, not all of these characteristics will be possible all of the time.

Rebalancing

The Foundation's policy asset allocation targets are useful for maintaining the risk profile adopted by the Committee. The portfolio's actual asset allocation will be monitored regularly relative to established targets detailed in the Addendum. The default should be to rebalance within the primary ranges subject to deviations due to extreme valuations and/or liquidity concerns.

Reporting

As well as reporting regularly to the IC at their quarterly meetings, the Foundation's appointed investment advisors will be asked to provide an annual update to the trustee board covering: Financial reporting and performance, non-financial reporting and performance (such as progress against the net zero goal), progress on alignment of the investment portfolio with the Foundation's values and strategic aims.

Recommended by Investment Committee: 5 September 2023

Approved by Trustee Board: 19 September 2023