

50. Central Finance Board (CFB)

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Review of the year ended 28 February 2015

1. Many positive achievements

In my first year as Chair, I look back on many positive achievements and some disappointments.

- 1.1 I was delighted that in July the Council re-affirmed our existing mission and purpose as being relevant to the needs of the Methodist Church in general and our clients in particular.
- 1.2 Further progress has been made on our approach to climate change, greatly assisted by the guidance of the Joint Advisory Committee on the Ethics of Investment (JACEI).
- 1.3 A significant impact was made on many companies as a result of our engagement on a range of ethical issues as we continue to punch above our weight in this area, often acting through the Church Investors Group.
- 1.4 We have put more of the necessary building blocks in place to achieve our objective of significantly growing the funds managed by Epworth, although in the past year growth itself has been slow.
- 1.5 While unusually all markets rose, most CFB funds did not achieve their benchmark returns after fees, although over the longer term relative performance remains good. Detailed figures can be found in the Investment Performance Schedule.

2. Performance

- 2.1 Unfortunately, although the absolute returns of our funds were good, only the Deposit Fund exceeded its benchmark (+0.2%) over the year under review. As with many others we were surprised by the strength of bond markets and our portfolios proved too defensive, having shorter durations than that of their benchmarks, leading to our bond funds underperforming by between 0.3% and 0.6%.
- 2.2 UK equity stock selection was close to neutral, but fees and dealing costs resulted in the Fund lagging 0.6% behind our proprietary ethical benchmark, although the underperformance was down to just 0.1% when compared to the traditional ethical index.
- 2.3 The Overseas Fund also lagged its benchmark by 0.6%, which was more than accounted for by expenses and unrecoverable tax. Asset allocation between geographical regions had a positive impact, but was offset by the underperformance from our US and Japanese portfolios being greater than the outperformance from the Pacific and Europe.
- 2.4 The Property Fund benchmark is only calculated on a quarterly basis, but in the calendar year, the CFB fund outperformed by 0.4%.

3. Fossil fuels: engagement and divestment

- 3.1 The CFB has made further significant progress in developing our approach to climate change with the adoption of a new policy on the ethical implications for different fuels. This builds on

our general climate change policy and the more specific one relating to the industry that is the largest single contributor to UK carbon emissions, electricity generation. All are based on *Hope in God's Future* a Statement adopted by the 2011 Conference. It made no ethical judgement on any fuel, but rather concentrated on greenhouse gas emissions. Consequently, JACEI advised that it is the emissions associated with any fuel, together with other environmental concerns and human rights issues, that should determine its ethical acceptability.

- 3.2 We have concluded that substantial exposure to thermal coal and tar sands would be incompatible with this approach. Similarly, we will avoid companies mainly involved in the exploration for and development of reserves of high emission fuels. In implementing our Policy on electricity generation two companies, Drax and RWE were judged as unacceptable for investment and it is thought likely that others will be added to this list as we implement the fuels policy.
- 3.3 However, whilst disinvestment has a part to play, it is through engagement that we are able to make a real difference. The transition to a low carbon economy will take time and the cleaner fossil fuels are certain to be part of the solution for many years. It would, in our view, be irresponsible for us to avoid the companies that provide such products. To do so would silence our voice, preventing us from applying pressure for them to reduce emissions and plan for a sustainable future.
- 3.4 In the past year, as part of the *Aiming for A* initiative, we co-filed shareholder resolutions encouraging BP and Shell to improve their disclosure and performance related to carbon emission. As a result of painstaking engagement, the boards of both companies took the unprecedented decision to encourage shareholders to vote in favour of the resolutions. We have been involved with the Church Investors Group (CIG) work that focused on Carbon Disclosure Project laggards. The 'significant improvement' seen in almost 60% of the companies approached has been academically assessed, with a 95% confidence level, as being due to the CIG engagement programme, providing strong justification for the engagement approach.
- 3.5 In addition to collaborating with others, we also continue to hold companies, such as Shell to account through regular detailed discussions. Our electricity generation policy also led to new engagements with three companies. Satisfactory responses were obtained from Centrica and E.On, but more work is required with SSE.

4. **Mining and other ethical issues**

- 4.1 Although it gains most attention, climate change is only one of the many ethical issues we address. In the past year these have included the living wage, excessive remuneration, human trafficking, water risk, tax justice and animal welfare. However, perhaps our most significant work was with the mining industry, as it sought input from the churches to help it develop sustainable business models for the common good. As a result of trust built up over many years, the CFB was asked by Anglo American to help with the process. This led to an ecumenical day of reflection at Lambeth Palace co-hosted by the President of the Methodist Conference and the Archbishop of Canterbury. It was attended by chief executives and chairmen of the world's largest mining companies, theologians and Church investors.
- 4.2 The preparation involved church representatives visiting mines to observe at first hand the environmental and community challenges. As a result theological input is being provided and tools developed to facilitate better engagement between companies and their local communities. This is a continuing process, which it is hoped will lead to mining operations that are not only financially successful but socially sustainable.

5. **A year of transition**

5.1 **... for staff**

Throughout the year we have been without our Chief Investment Officer, Russell Sparkes, who remains on long-term sick-leave and trainee Severine Itany, who is on maternity leave. Given that we had already identified the need for a larger investment team, staff resources have been very stretched. Stephen Beer has taken the role of acting CIO, whilst in January Mathew Richards joined us as a Senior Fund Manager with responsibility for overseas equities. Two new trainee positions were established and filled by Catherine McNally and Matt Jones. The new team will need time to become established before we can judge whether it is now the optimal size.

5.2 **... for premises**

It is also good to report that a new lease on our Bonhill Street offices was signed. Unfortunately, as is often the case with property matters, the process took longer than anticipated and the refurbishment was only completed in March. However, we now have smart modern premises that are fit for purpose, which make the effort worthwhile. I would also like to take the opportunity to thank Bill Seddon and all our staff, not only for the way they coped with the disruption to ensure a seamless continuity in the services we provide during the refurbishment, but also for their hard work and commitment to excellence on a daily basis.

5.3 **... for Epworth**

One result of the disruptions of the last year has been that we have not been able to pursue the development of Epworth Investment Management as quickly as we may have wished. To facilitate the additional investment required, the CFB has now acquired complete control having bought out the other shareholders last August. A development strategy is now in place but there is an urgent need to recruit someone to lead our marketing effort. During the year Roger Smith and Colin Pearson stood down from the Board with our grateful thanks for their service and were replaced by John Gibbon and Julian Parker.

5.4 **... for Council**

In my first year as Chair, it seemed appropriate for us to review how the CFB Council exercises its responsibilities, particularly with Epworth becoming a wholly owned subsidiary. We therefore held a workshop of the Council and senior staff. As a result, it was agreed to reduce the number of Council meetings from eleven to six each year supplemented by up to five Management and three Audit committee meetings. During the year Graham Boyd had to step down, which left Council two short of its maximum membership. As a result a search for new members was begun and we are fortunate to have identified three well qualified candidates in Caroline Edwards, Peter Hobbs and the Revd R Andrew Laird. They have been in attendance at our meetings since January and will formally join the Council at our General Meeting, when we will also be saying farewell to the Revd Jennifer Potter. I was delighted that John Gibbon accepted my invitation to become Vice-Chair. It was daunting to follow in the shoes of our previous Chair, Roger Smith, but my task has been made easier by the wisdom and support of all my fellow Council members and I wish to thank them for their efforts on behalf of the Methodist Church.

6. **Looking forward**

6.1 We have made a number of changes in the past year in order to continue delivering a high quality service for Methodism. However, if we are to continue to realise this ambition we cannot afford to stand still and must invest in our systems and our team. This will have an impact on costs, but needs to be accepted if the CFB is to provide good investment returns

consistent with the ethical position of the Methodist Church both now and in the future, a result we remain determined to deliver.

Investment Performance

External Assessment

(Source: Portfolio Evaluation, except where stated)

28 February 2015

Index	1 year to 28.02.2015	5 years to 28.02.2015	10 years to 28.02.2015
Equity			
CFB UK Equity Fund	+4.5	+10.4	+7.6
FTSE All Share Index	+5.6	+10.1	+7.8
CFB proprietary ethical Index	+5.1	+10.5	+7.7
FTSE All Share Index (traditional ethical adjustment)	+4.6	+9.8	+7.3
CFB Overseas Fund	+17.9	+11.7	+9.8
FTSE All World ex U.K Index	+18.5	+11.1	+9.7
CFB Managed Equity Fund¹	+6.5	+10.6	+8.0
Managed Equity Fund Composite Index	+7.4	+10.3	+8.1
Managed Equity Fund Composite Index (using CFB proprietary UK Index)	+7.0	+10.6	n/a
Managed Equity Fund Composite Index (using traditional UK ethical adjustment)	+6.6	+10.0	+7.8
CFB Managed Mixed Fund¹	+8.0	+9.8	+7.6
Managed Mixed Composite Index	+8.4	+9.4	+7.6
Managed Mixed Composite Index (using CFB proprietary UK Index)	+8.1	+9.3	n/a
Managed Mixed Composite Index (using traditional UK ethical adjustment)	+7.8	+9.2	+7.4
Fixed Interest			
CFB Managed Fixed Interest Fund¹	+7.7	+5.5	+5.6
Managed Fixed Interest Composite	+8.3	+5.6	+5.5
CFB Short Fixed Interest Fund	+4.4	+4.1	+5.0
Short Gilt Composite Index	+5.0	+4.1	+5.0
CFB Gilt Fund	+11.2	+6.6	+5.9
FTSE All Stock Gilt Index	+11.7	+6.8	+6.0
CFB Corporate Bond Fund¹	+11.0	+7.6	+6.5
Corporate Bond Composite Index	+11.4	+7.6	+5.5
Inflation Linked			
CFB Inflation Linked Fund	+15.7	+9.5	+7.7
FTSE All Stock Index Linked Index (gilt only)	+16.0	+9.4	+7.7

Property

CFB Property Fund^{1,3}	+17.6	+9.1	n/a
IPD All Balanced Funds Index ^{2,3}	+17.2	+8.9	+4.3

Cash (AERs)

CFB Deposit Fund¹	+0.6	+1.0	+2.7
Higher Rate Bank Deposits (over £10,000)	+0.1	+0.1	+0.8
1 Week LIBID	+0.4	+0.4	n/a

¹ Source: CFB

² Source: IPD

³ Performance to 31 December 2014

Summary statement of change in unit holders' net assets Year to 28 February 2015

CFB Funds	Net Assets at 28/2/2014 £'000s	Net Creations/ Cancellations £'000s	Change in Net assets £'000s	Net Assets at 28/02/2015 £'000s
UK Equity Fund	359,448	10,105	6,352	375,905
Overseas Fund	159,999	(21,330)	24,331	163,000
Gilt Fund	37,005	(4,340)	3,010	35,675
Corporate Bond Fund	88,079	(647)	6,487	93,919
Short Fixed Interest Fund	8,065	993	127	9,185
Inflation Linked Fund	30,179	(4,219)	4,181	30,141
Property Fund	15,194	1,480	1,433	18,107
Deposit Fund	354,324	5,733	0	360,057
Less: CFB Deposit Fund balances held in other CFB funds	(6,664)	1,004	0	(5,660)
Total	1,045,629	(11,221)	45,921	1,080,329

*****RESOLUTIONS**

50/1. The Conference adopted the Report of the Central Finance Board.

50/2. The Conference elected the following persons to the Central Finance Board for the period of one year from 1 September 2015:

Dr Keith Aldred, Amanda Amor, Ruby Beech, Graham Boyd, Ronald Calver, Peter Cussons, Christopher Daws, Ralph Dransfield, Caroline Edwards, John Gibbon, Anne Goodman, Hazel Griffiths, Alan Groves, Frank Guaschi, Sue Haworth, Peter Hobbs, the Revd R Andrew Laird, Theophilus Mensah, Nick Moore, the Revd Leslie Newton, John O'Brien, Sir Michael Partridge, Colin Pearson, Alan Pimlott, the Revd Jennifer Potter, John Reynolds, John Sandford, Maureen Sebanakitta, Gordon Slater, Andrew Slim, the Revd Eleanor Smith, the Revd Kenneth E Street, Anthea Sully, the Revd Graham Thompson, Geoffrey Wilcox, Michael Willett, Terry Wynn, Garry Young

Reasoned Statement for New Nominations

Caroline Edwards – a Chartered Management Accountant who operates as an independent programme manager specialising in finance and shared service centre transition.

Peter Hobbs – a semi-retired executive in the insurance sector with experience in investment strategy and performance.

R Andrew Laird – a CIPFA qualified accountant who has worked across the private and public sector and a Methodist Minister since 2003, presently stationed in the Mid-Warwickshire Circuit.