Central Finance Board of the Methodist Church (CFB) Financial Statements

at 28 February 2018

Central Finance Board
of the Methodist Church

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Chair's statement

Introduction

I started my statement last year with a quote from a financial publication that reported how religious organisations are leading the fight with Corporations over Climate Change. That was a prophetic comment as our work on Climate Change has intensified even further this year. This follows a notice of motion at the 2017 Methodist Conference that asked the Joint Advisory Committee on the Ethics of Investment to examine how the extractive industry is preparing for its commitments under the Paris climate accord. To support the Committee's response the ethics team at the Central Finance Board (CFB) has undertaken ground breaking work examining the modelling of climate change and identifying scenarios that the World needs to meet to deliver the promises made at Paris. The team are working towards Conference's requirement to disinvest from any extractive company whose business plan is not aligned with Paris by 2020. It is market leading work and I am proud of the professional and diligent way that the CFB has approached this challenge. It once again emphasises that Faith investors in the investment world remain at the heart of the work to protect God's kingdom.

In his CEO report, David describes the numerous projects that the team have taken on over the last 12 months. Their work is only half finished and another year of investment and endeavour lies ahead. I must thank them once again for their support and unflinching commitment. We are facing several challenges – but the Central Finance Board has never been so well placed to meet them.

Our financial position

Last year I reflected on how a deferral in costs and a strong investment market had generated surpluses for the Central Finance Board. These surpluses have helped the Council make a substantial investment in the infrastructure of the business. In his CEO's report, David Palmer describes the operations review that is ongoing. We are automating our processes and improving the speed of our client reporting. The Central Finance Board as a statutory body is not regulated but we seek to manage ourselves as though we were. This investment enables us to keep up with a number of regulatory changes and also relieves considerable pressure on the operations team.

We continue to see attrition from our major clients, the Methodist pension schemes, as their Trustees seek to reduce the long-term investment risk in the Schemes' assets by using a liability driven investment approach (LDI). These LDI solutions are offered by third parties and over the last two years we have seen approximately £75m leave our management in favour of this alternative investment approach. This is a trend that we expect to continue in the year ahead.

Whilst the assets managed by the Central Finance Board saw some attrition, Epworth's Affirmative Deposit fund proved to be attractive to external charity investors, with over

£30m of money from new investors during the year. This included Housing Associations and other faith groups.

The overall financial position of the Central Finance Board remained stable over the year. Good investment markets meant that the combined assets under management of the Central Finance Board and Epworth at the year end stood at a record £1.4bln. Despite the costs of the operations project, a small trading surplus was recorded.

In 2018/19 we expect our surpluses to be reduced as the second half of the operations project is delivered and we have other substantial increased costs. Following a European directive we are now bearing the cost of investment research that we receive from other investment houses. We are also improving our controls this year through the engagement of an independent internal auditor.

At the time of writing this report a financial challenge that we face is a potential deficit in the PASLEMC pension scheme. We are the second largest employer in this defined benefit scheme and we are working with the Connexional team on a funding plan for this past service deficit.

Our long-term plan to improve the financial position of the Central Finance Board remains to grow the assets in our regulated subsidiary, Epworth Investment Management. David will report more on this but I am pleased to advise that substantial progress has been made over the last year as we build an investment offering based on Christian ethics for the whole charity community.

Personnel

A year ago I was reflecting on the strain that a number of unfilled vacancies in the Central Finance Board had placed on the team. I am therefore pleased to report that these vacancies were filled during the year and that we have increased our management team through the recruitment of a compliance officer and a head of business development. Until the operations review is completed, we will continue to have pressure on our operations team around fund dealing days and I remain grateful to them for all the extra work that they put in when the rest of the office has left for home in the evening. I hope that I will be reporting next year that these pressures have been removed by the success of our operations review.

Council membership

We have added to our experienced Executive this year with appointments of the Revd Anne Ellis and Morwenna Williams to the Council. Their scrutiny of the activities of the Central Finance Board has made an immediate impact and I look forward to working with them for many years to come. Regrettably I have to advise that Graham Boyd stepped down from Council during the year due to other work commitments. Graham's investment knowledge and background in further education made him a valuable contributor to the Council and I will miss his insightful presence.

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Chief Executive Officer's report

Ethical review of the year

The greatest joy in my first full year at the Central Finance Board has come from the work of our ethics team. Christian ethics have always lain at the heart of the investment team but their passion and commitment has bought rewards far beyond investment returns. In the last few months the work of the team has been dominated by the need to meet the request of the 2017 Methodist Conference to consider the grounds for disinvesting from companies in the extractive sector by 2020. The groundwork for this critical piece of work has been laid by a comprehensive study of the academic research that models the impact of the use of various fuel types on global temperatures. A core "scenario" has been identified and the team's next steps are to assess how extractive companies impact upon this scenario. This work will use 5 key criteria that have been agreed with the Joint Committee on the Ethics of Investment. Our Chair has already reflected on this work but it has dominated the activity of the CFB for the last 8 months. Despite this call on our resources, the team has still managed to engage on many other areas of ethical concern. There have been 33 examples of direct contact with the senior executives of companies in the last year. Through our collaborative engagements through a number of faith and industry groups this number rises to in excess of 400.

I commend to you the annual report of the Joint Advisory Committee on the Ethics of Investment that will be submitted to Conference this summer. Amongst the activity I would highlight is:

Human Rights. We have challenged a number of sectors on their Modern Slavery polices. This includes the telecom sector on the use of child labour in Africa's cobalt mines, house builders on health & safety conditions in the quarries that produce the granite for their fitted kitchens and supermarkets on the abuse of cheap labour in their fast car wash sites.

Farm, nutrition & animal welfare. We believe that we are the first institutional investor to introduce a policy that looks at farm related animal risk, antibiotic resistance in the livestock production sector and fair trade issues.

Water Risk. We continue to lead engagement on water risk for the Church investors group

One feature of our work continues to be our voting record at general meetings where we have actively voted against Board committees that support excessive executive pay, lack of Boardroom diversity or ignore their lower paid. We voted against over half of shareholder resolutions seeking to approve Executive remuneration:

CFB: Voting record on shareholder resolutions

Type	For	Oppose	Abstain	% Against or abstain
Auditors	376	2	1	0.79%
Directors	2080	383	9	15.86%
Remuneration	386	389	0	50.19%
Executive Pay Scheme (UK)	21	11	0	34.38%
Shareholder Capital (Europe)	396	90	0	18.52%
Other	1632	175	18	10.58%
TOTAL	4891	1050	28	18.06%

Investment review of the year

It has been another extraordinary year for investment markets. The long period of falling interest rates has finally come to an end as central banks increased their key lending rates in both the USA and the UK. For the Gilt market this has signalled the end of a bull run that started several decades ago. For the stock market this would also normally signal tougher times ahead but the world's economic growth has been sustained by the package of tax cuts brought in by the Trump administration in the USA. The substantial cuts to both corporate and individual tax rates led to another surge of support to the US stock market. Further help has come from a tax change that encourages the repatriation of capital by major international US corporations. Initially these measures led to some wage improvement but the likely longer term beneficiaries are shareholders through share buy-backs and dividends. This fiscal stimulus has happened while the federal reserve board is concerned about inflationary pressures and is using monetary policy to calm the economy. This tension between fiscal and monetary policy will make for a more uncertain investment environment as Trump starts to think about the prospects for his re-election.

The UK has been dominated by progress – or lack thereof – on the BREXIT negotiations. The UK is showing modest economic growth but is lagging behind the rest of the G8. Uncertainty over future access to international markets and labour has affected both corporate and consumer spending. The UK stock market initially benefited from the sell off in sterling after the BREXIT referendum. To maintain this equilibrium the next few months must bring clarity on the UK's access to international markets.

The performance of the CFB funds has had a mixed year. Our approach to company analysis in the UK equity market has seen a sustained period of outperformance. In contrast our third party managers in overseas equities have been more cautious in strong markets. We are currently reviewing an approach to international equities that would replicate our successful methodology in the UK. Our fixed interest funds were held back by our caution on UK interest rates several years ago.