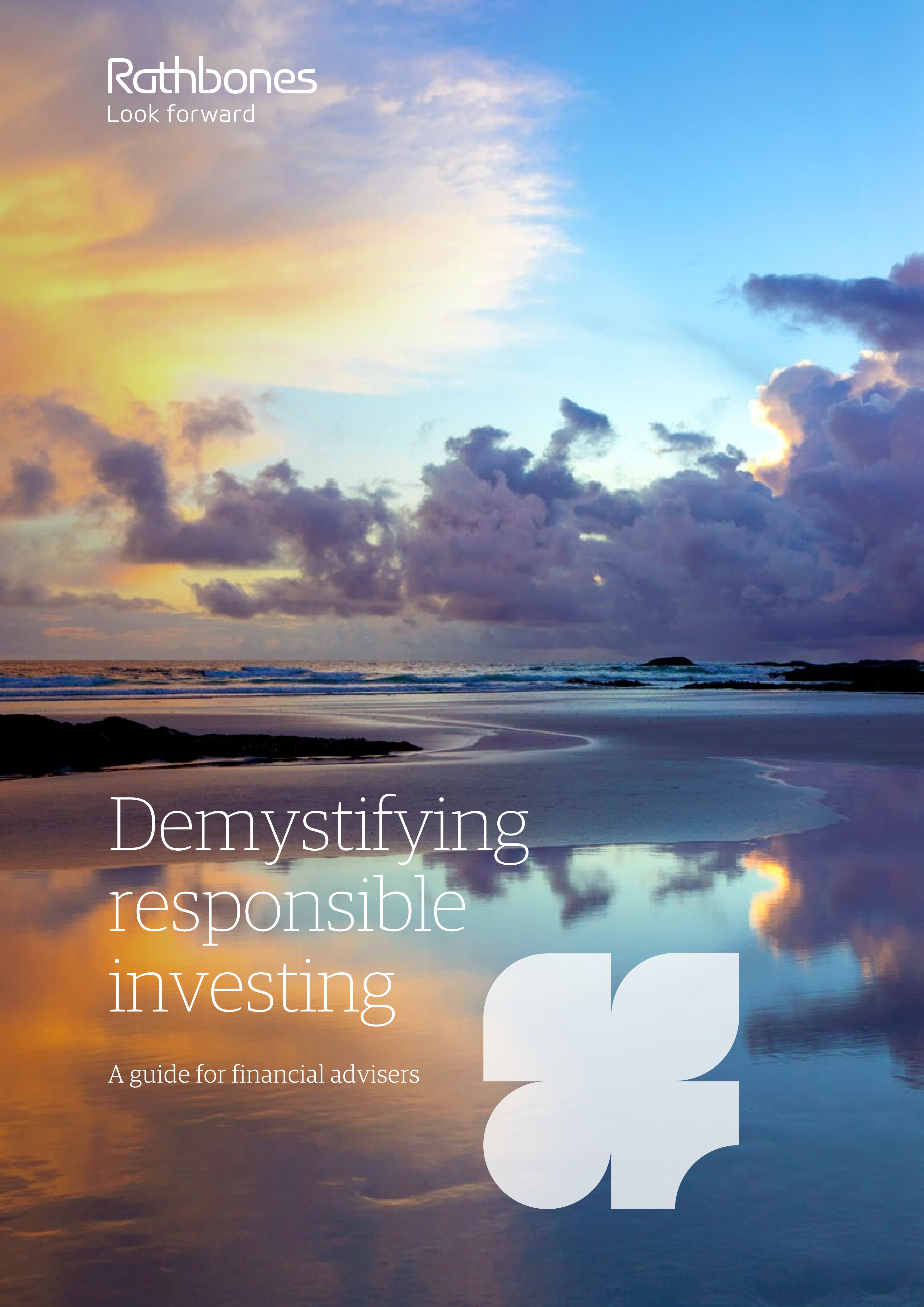


Rathbones
Look forward

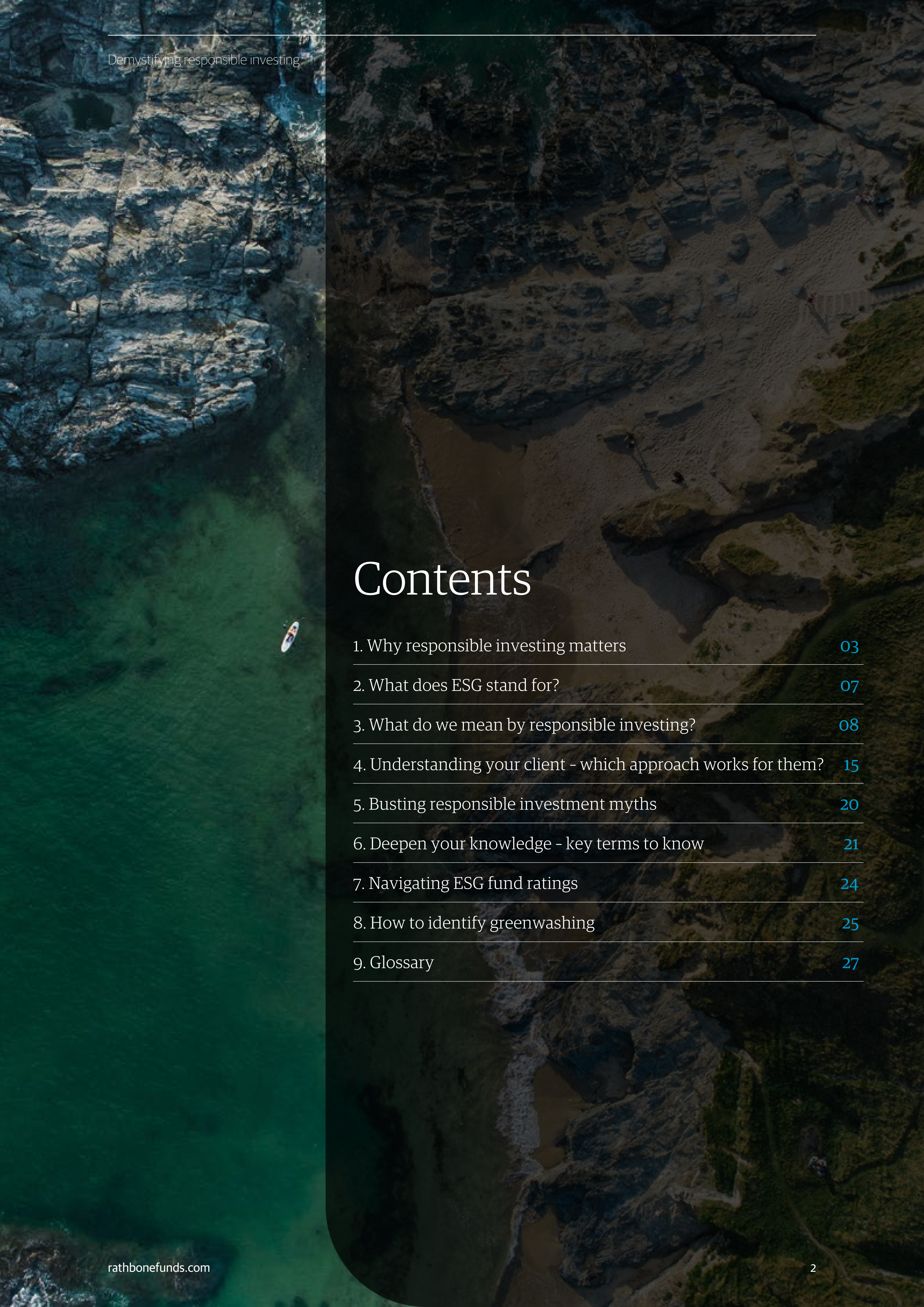
Demystifying responsible investing

A guide for financial advisers

As public awareness of climate change and social inequalities has increased, so too has interest in responsible investing.

Previously a niche area of investment, it is quickly gaining attention from investors of all types. However, this can be a complicated area of investing to navigate. There are multiple approaches to responsible investing and a variety of ways to analyse companies for their sustainability credentials.

While the end goal is often similar - to do the right thing for the environment and society - it is crucial to understand the differences between each approach because it helps investors to make informed choices about where they are putting their money. This guide has been designed to equip you with the information you need to have meaningful discussions with your clients about responsible investing and ultimately to provide them with investment solutions suited to their needs.



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Why responsible investing matters

Responsible investing has a long history in the UK. It began with ethical investing, which first emerged in the late 1970s, and the first unit trust to use ethical screening arrived in 1985. Rathbones has long recognised the importance of responsible investing and were one of the early private wealth managers to sign up to the UN-backed Principles for Responsible Investment in 2009. Going even further back, Rathbone Greenbank Investments (Greenbank), which is the specialist ethical, sustainable and impact arm of Rathbones, launched one of the UK's first ethical portfolio services in 1992 and was formally established in 2004.

Rathbones has long recognised the importance of responsible investing and were one of the early private wealth managers to sign up to the UN-backed Principles for Responsible Investment in 2009

Since then, responsible investing has gradually grown in popularity and now encompasses a much wider range of approaches. The legal backdrop has also accelerated interest in responsible funds with the introduction of regulations aimed at tackling climate change and increasing transparency around how fund managers are fulfilling their responsibilities as long-term stewards of client investments.

Did you know?

According to the World Economic Forum Global Risks Report 2021, the top three most likely global risks are all climate-change related: extreme weather, climate action failure and human environmental damage – with biodiversity loss at number four.

The 'Attenborough' effect

There has been a clear shift among consumers to make more sustainable choices in their daily lives, from cutting down on single-use plastics to reducing meat in their diet. High-profile television programmes like Sir David Attenborough's Blue Planet documentary for the BBC about the negative environmental impacts of pollution and litter have no doubt played a role in swaying public opinion. Importantly, there is evidence that consumers are applying the same thinking to their investment decisions.

Research by the Wisdom Council[1], commissioned by Rathbones, suggests the feeling of responsibility cuts across all age groups contributing to pensions, with:

78% of respondents believing it's important that they play a role in protecting the environment

81% thinking every company should be as environmentally responsible as they can be

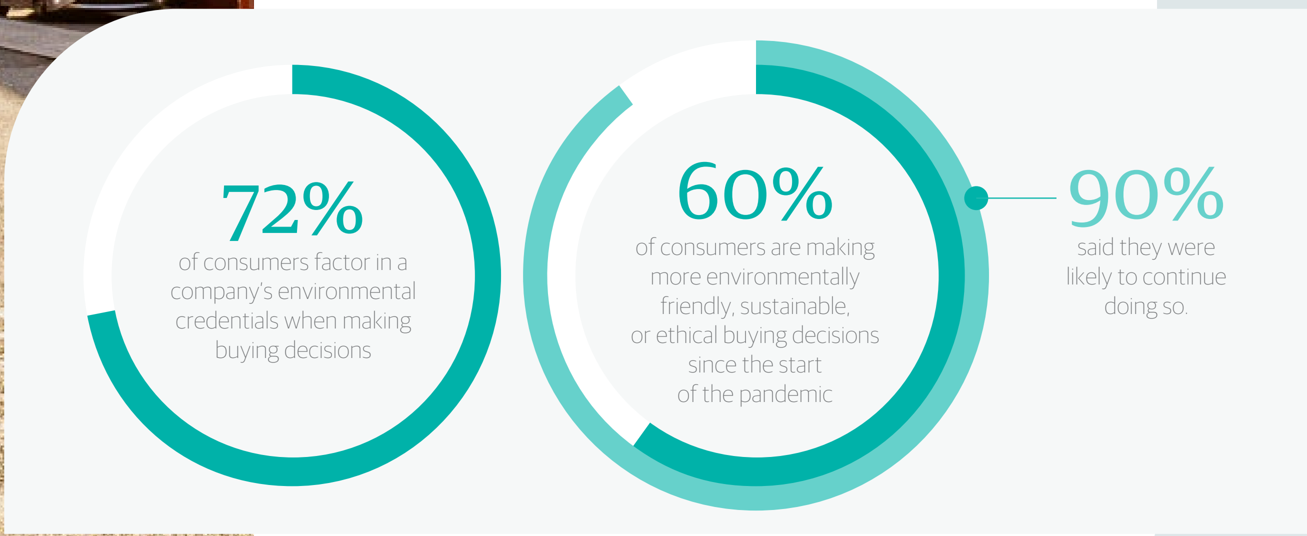
A large-scale survey commissioned by AllianzGI also found that 83% of UK-based investors are very interested in sustainability in general and 70% say that they would invest in funds with sustainability goals. Similarly, according to Schroders' 2019 Global Investor Study of more than 25,000 people globally, 60% believe their individual investment choices can make a difference to building a more sustainable world.

1. www.thewisdomcouncil.com

Money talks

More and more often, consumers are thinking about the environmental and social impacts of their purchases, and the COVID-19 pandemic has only accelerated this trend. Eon, the energy company, surveyed more than 2,000 consumers in November 2020 and found that 72% said they factor in a company's environmental credentials when making buying decisions. Similarly, research by Accenture in August 2020 found 60% of consumers are making more environmentally friendly, sustainable, or ethical buying decisions since the start of the pandemic and 90% said they were likely to continue doing so.

Crucially, these consumer trends are spilling over into financial decisions. In February 2021 alone, UK investors put nearly £2.5 billion into sustainable funds, which was a large inflow considering that these funds only make up 7% of the fund universe. For Europe as a whole in 2020, sustainable open-ended funds and exchange traded funds (ETFs) attracted net inflows of €233 billion – almost double the figure for 2019 – and 505 new funds came to the market.[2] Given the number of new funds being launched, the task of navigating and recommending funds to clients is becoming more challenging, which is why it is more important than ever to fully understand what responsible investing means and how strategies can differ.



2. Source: Morningstar

Regulations on the rise

It is not just consumers who are accelerating the sustainability drive; government regulation is also playing a role. The European Union (EU) has passed significant sustainability-related regulations, including the EU taxonomy for sustainable activities, which came into force in 2020, and the Sustainable Finance Disclosure Regulation (SFDR), which came into effect in March 2021. The EU introduced these regulations to create a consistent way of categorising investments and funds as sustainable. This is part of a drive to improve transparency and make investors' lives easier.

More significantly, the ESG amendment to the Markets in Financial Instruments Directive (MiFID II) is the rule that has the biggest impact on advisers. It makes it mandatory for clients' sustainability preferences to be considered when determining if a financial product is suitable. This means advisers need to consider sustainability risks when selecting financial products for clients, ask clients about their ESG preferences as part of the suitability review, and explain how clients' ESG preferences have been incorporated into the recommendation.

While these rules currently only apply within the EU, the **Financial Conduct Authority (FCA) has indicated its intention to introduce similar regulations in the UK**. Therefore, you may want to get ahead of the curve and start discussing these issues with clients now if you are not already doing so.

Did you know?

EU regulations make it mandatory for advisers to consider sustainability risks when selecting financial products for clients, ask clients about their ESG preferences as part of the suitability review, and explain how clients' ESG preferences have been incorporated into the recommendation.

2

What does ESG stand for?

When people talk about responsible investing, there are three letters which will almost definitely always come up in conversation: E, S and G. They stand for environmental, social and governance (ESG), and represent a set of factors that investors use to determine if a company is operating responsibly. Alongside financial analysis, these principle categories form the basis of responsible investment approaches.

Environmental factors

This covers matters relating to the quality and functioning of the natural environment, such as

- climate change
- resource depletion
- waste
- pollution
- deforestation
- water scarcity.

Investors will look at a number of metrics when determining a company's environmental record, such as total carbon emissions, energy efficiency, supply chain sustainability, waste management and wastewater treatment.

Social factors

This focuses on the rights, well-being and interests of people and communities, covering issues such as

- human rights
- modern slavery
- employee relations
- data security and privacy
- product safety.

For example, investors may look at how companies treat their employees and how well they are paid, how safe their products are, and whether they have had any data security breaches.

Governance factors

This relates to the governance of companies and other investment vehicles, focusing on issues such as

- executive pay
- board structure
- board diversity
- shareholder rights
- bribery and corruption.

Investors may look at the number of independent directors on a board, as well as female representation at senior management and board level.

3

What do we mean by responsible investing?

Responsible, sustainable and impact investing are just a few of the terms that are frequently used interchangeably. Quite understandably, this may seem confusing, especially because they all actually mean different things!

Responsible investing is the purposeful integration of ESG considerations into investment management process and ownership practices.

It can be thought of as an umbrella term which encompasses a spectrum of different investment approaches within it including ESG integrated investing, sustainable investing and impact investing. These can each be implemented into the investment process through a number of different sub-approaches depending on what the client wants their portfolio to look like and do. As you work your way from ESG integrated investing to impact investing your focus shifts from maximising financial returns and managing ESG risks to actively pursuing sustainable opportunities and addressing societal challenges.

Rather than adopt a single approach, many funds will combine more than one of these strategies in their investment process. Therefore, without transparency and complete clarity of the specific approach and process that is being used, it would be almost impossible to have any confidence that a fund is aligned with a client's values.

Responsible investing

ESG integrated Investing		Sustainable Investing		Impact Investing
ESG integration Stewardship	Negative/ethical screening or exclusions	Best-of-sector investing	Sustainability-focused investing Thematic investing	

Main focus:

Maximising financial returns → Generating positive environmental and social impact

Features

- Considers financial impact of ESG factors in investment decision making
- Avoids harm
- Benefits stakeholders and pursues ESG opportunities
- Contributes to sustainable solutions
- Focuses specifically on intentional and measurable impact solutions

ESG integrated investing

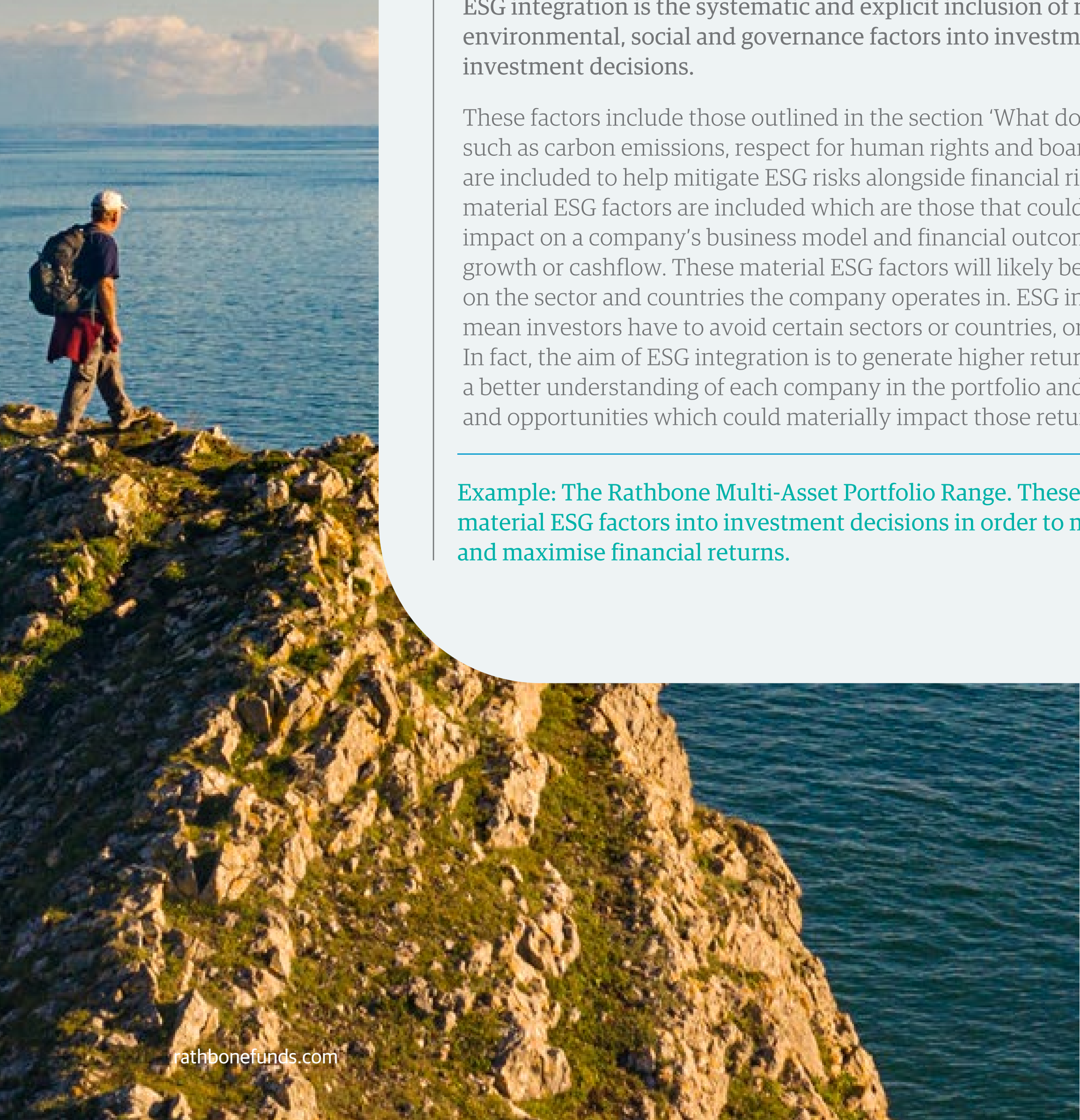
This approach embeds ESG risk (and opportunity) considerations into the investment process. The main aim of ESG integrated investing is to maximise financial returns whilst taking into account ESG factors which could impact those returns. ESG integrated investing can be implemented into the investment process through a number of sub-approaches as outlined below.

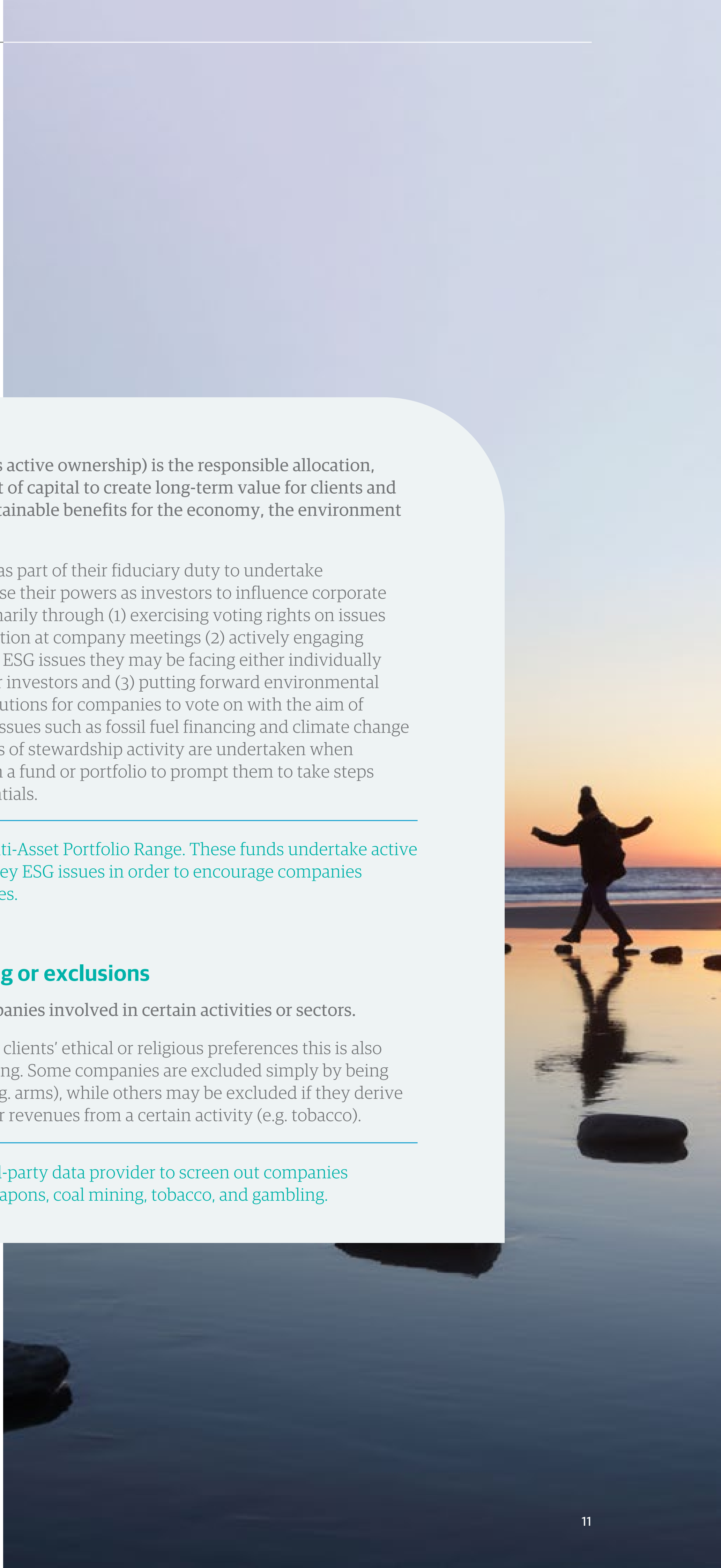
ESG integration

ESG integration is the systematic and explicit inclusion of material environmental, social and governance factors into investment analysis and investment decisions.

These factors include those outlined in the section 'What does ESG mean?' such as carbon emissions, respect for human rights and board structure and they are included to help mitigate ESG risks alongside financial risks. Crucially, only material ESG factors are included which are those that could have a significant impact on a company's business model and financial outcomes, such as revenue growth or cashflow. These material ESG factors will likely be different depending on the sector and countries the company operates in. ESG integration does not mean investors have to avoid certain sectors or countries, or sacrifice returns. In fact, the aim of ESG integration is to generate higher returns by gaining a better understanding of each company in the portfolio and the ESG risks and opportunities which could materially impact those returns.

Example: The Rathbone Multi-Asset Portfolio Range. These funds integrate material ESG factors into investment decisions in order to mitigate ESG risks and maximise financial returns.





Stewardship

Stewardship (also known as active ownership) is the responsible allocation, management, and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.

Fund managers often see it as part of their fiduciary duty to undertake stewardship activities and use their powers as investors to influence corporate behaviour. This is done primarily through (1) exercising voting rights on issues such as executive remuneration at company meetings (2) actively engaging with companies on material ESG issues they may be facing either individually or collaboratively with other investors and (3) putting forward environmental and social shareholder resolutions for companies to vote on with the aim of compelling change on ESG issues such as fossil fuel financing and climate change reporting. Often, these forms of stewardship activity are undertaken when a company is already held in a fund or portfolio to prompt them to take steps to improve their ESG credentials.

Example: The Rathbone Multi-Asset Portfolio Range. These funds undertake active voting and engagement on key ESG issues in order to encourage companies to improve their ESG practices.

Negative/ethical screening or exclusions

This means excluding companies involved in certain activities or sectors.

If the screens are based on a clients' ethical or religious preferences this is also referred to as ethical screening. Some companies are excluded simply by being active in a particular area (e.g. arms), while others may be excluded if they derive more than 5% or 10% of their revenues from a certain activity (e.g. tobacco).

Example: A fund uses a third-party data provider to screen out companies involved in controversial weapons, coal mining, tobacco, and gambling.

Sustainable investing

This approach targets investments that contribute to positive environmental and social objectives, alongside good governance practices (and without incidence of significant harm) thereby supporting progress towards a more sustainable world.

Sustainable investing typically also includes the practices mentioned earlier, such as ESG integration, stewardship and negative screening. So, as well as targeting competitive risk-adjusted financial returns; avoiding harm and mitigating ESG risks, sustainable investing also aims to benefit all stakeholders by pursuing ESG opportunities.

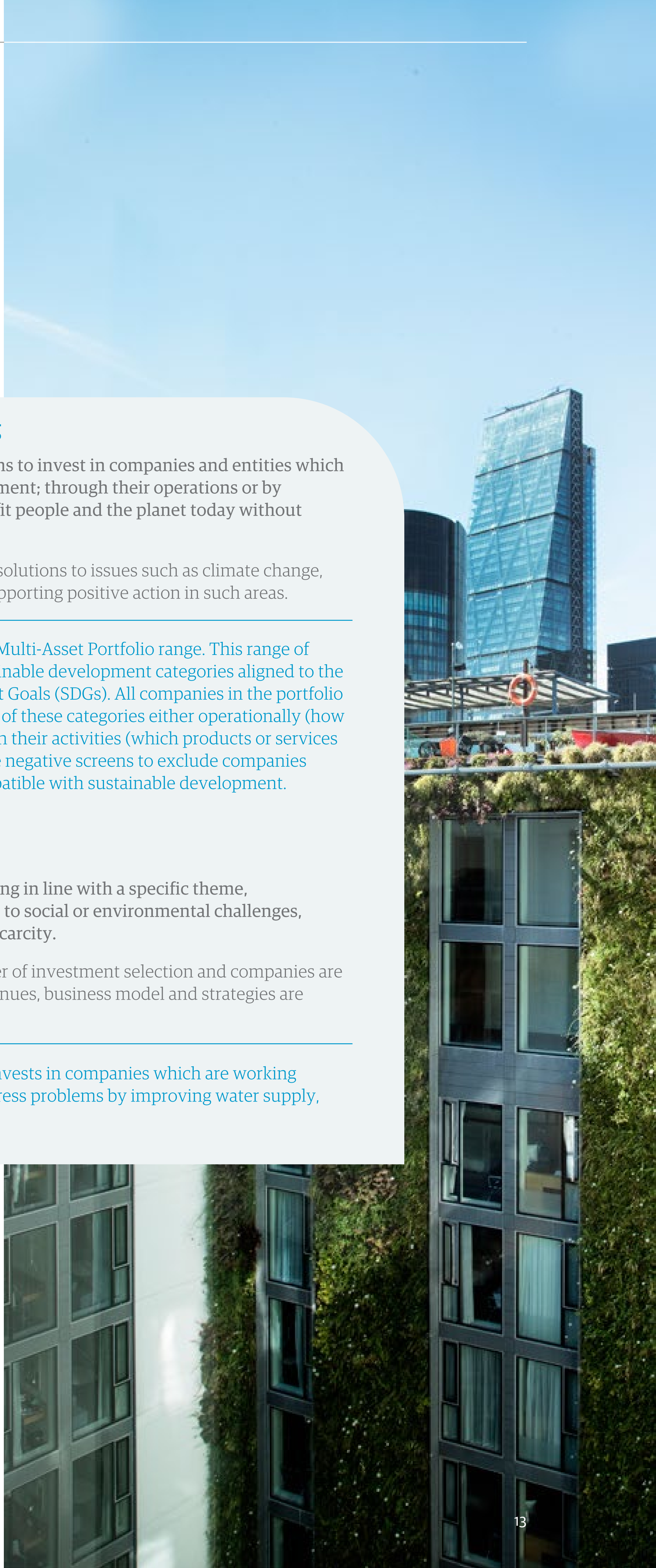
Sustainable investing can be implemented into the investment process through a number of sub-approaches as outlined below.

Best-of-sector investing

Best-of-sector investing looks at relative ESG performance within specific industries or sectors.

Preference is given to companies displaying better environmental, social and governance standards relative to their peers. For example, this may mean only choosing or overweighting companies that have an ESG score above a certain threshold (best-performing) or removing or underweighting companies that have ESG scores below a certain threshold (worst-performing). Unlike negative screening, a portfolio may retain exposure to companies that are not typically considered sustainable, such as fossil fuel companies.

Example: Within each sector, a fund ranks all the companies by their carbon emissions. Companies with the highest carbon emissions are removed and companies that are ranked second-worst are limited to 10% of the fund.



Sustainability-focused investing

Sustainability-focused investing aims to invest in companies and entities which are supporting sustainable development; through their operations or by providing goods/services that benefit people and the planet today without compromising their future needs.

Often companies that are providing solutions to issues such as climate change, biodiversity, and good health, are supporting positive action in such areas.

Example: The Rathbone Greenbank Multi-Asset Portfolio range. This range of funds invests in line with eight sustainable development categories aligned to the UN-backed Sustainable Development Goals (SDGs). All companies in the portfolio must have positive alignment to one of these categories either operationally (how the business behaves) and/or through their activities (which products or services they provide). The portfolios also use negative screens to exclude companies involved in activities that are incompatible with sustainable development.

Thematic investing

Thematic investing involves investing in line with a specific theme, or set of themes, that seek solutions to social or environmental challenges, such as gender inequality or water scarcity.

The chosen theme(s) is the key driver of investment selection and companies are chosen based on how well their revenues, business model and strategies are aligned to solving chosen issues.

Example: A water fund which only invests in companies which are working to conserve water and solve water stress problems by improving water supply, efficiency, and quality.

Impact investing

Impact investors intentionally target investments that generate positive and measurable social and environmental impacts alongside a financial return.

What sets impact investing apart from the other approaches is that investments must be intentionally contributing to environmental or social solutions, and this must also be measurable over time, which may not be the case for sustainable investments. Clients who are interested in impact investing may prioritise achieving sustainable outcomes over financial returns, as these strategies often involve accepting lower financial returns or a higher level of risk.

How can this be implemented in practice?

Given that impact investing aims to achieve specific results, investors typically select investments that have a clearly defined purpose. This may involve investing in social, green or sustainability bonds where funding is ring-fenced for specific projects, or private impact investing where the client invests directly in unlisted projects, companies, or initiatives. This type of investing generally requires a higher level of expertise to research and find opportunities, so clients who choose impact investing will typically achieve this through a discretionary fund manager.

Example: A bespoke portfolio created with the intention of reducing social issues including poverty and homelessness through targeted investments in those areas. The investment manager of the portfolio would report the positive impacts of those investments to the client.

4

Understanding your client – which approach works for them?

When carrying out a suitability review with a client it is important to find out how they feel about sustainability issues and how they may or may not want this to be reflected in their investments.

The questions below should provide you with a guide of how to start the responsible investing conversation with your client. The aim of this is to find out which investment approach best matches their needs (traditional, ESG integrated, sustainable or impact), as well as which sub-approach would be best to implement this into the investment process. For example within sustainable investing, would sustainability-focused investing or thematic investing be more appropriate.

We envisage that within each stage a larger number of clients will respond 'Yes' to the first couple of questions but as you move through them, and the level of sustainability requirements increases, fewer clients will be left. We also recognise that client knowledge and importance placed on responsible investment and sustainability will vary significantly, therefore some questions might not be appropriate for all clients.

Stage

1

Is a responsible investment approach appropriate for your client?

The first two questions in this stage are designed to help identify whether your client needs a responsible investment approach at all or whether a traditional approach would be more suitable. The second two questions should shed some light on the extent to which they would be happy to incorporate their values into their investments which will help match them to a responsible investment approach in stage 2.

1: In your day-to-day life, how important are environmental, social and/or ethical issues to you?

2: Would you like your values regarding these issues to be reflected in some way within the investment approach of your portfolio?

3: Would you accept if the universe from which your fund manager chose investments was restricted due to the consideration of your values within your portfolio?

4: Would you be willing to potentially forego returns to have your values reflected within the investment approach of your portfolio?

If the first two questions are not important to your client then a traditional investment approach is likely to be most suitable and the rest of the questions would not need to be asked. However, if your client responds positively to them, then move onto Stage 2.

If your client responds more negatively to questions 3 and 4 they are likely to align more towards ESG integrated investing rather than impact investing on the responsible investing spectrum. However, Stage 2 should further help to match them to the most suitable specific approach.

Did you know?

Moving your pension savings to sustainable funds can be 27 times more efficient at reducing your carbon footprint compared to shortening your showers, flying less, travelling on public transport and eating less meat.

Stage

2

Which responsible investment approach is appropriate for your client?

Now you have been through stage one and you know your client requires some level of responsible investment within their portfolio, this section is designed to drill down further to uncover more about which specific responsible investment approach might be the most suitable.

1: Do you want your fund manager to consider environmental, social and governance (ESG) factors during their financial analysis of companies (and governments)?

2: Would you like your fund manager to vote and engage with companies, held in your fund, on relevant ESG issues?

3: Do you wish to avoid investing in companies which operate in ways or within sectors/industries that you disagree with or go against your values?

4: Do you only wish to invest in companies which are positively contributing to or supporting sustainable development?

5: Do you require the sustainability impacts of your investments to be directly measurable and reported to you?

6: Is it important to you that your fund manager prioritises sustainability outcomes over financial outcomes?

Finding a multi-asset solution

There are many different approaches and combinations of approaches within responsible investing. For instance, some funds will integrate ESG considerations and stewardship practices into their investment process but not carry an official sustainable badge. For example, Rathbone's Multi-Asset Portfolios follow this approach. However, the Rathbone Greenbank Multi-Asset Portfolios go a step further, including negative screening and positive alignment, to look for investments that are benefitting people and the planet. These portfolios therefore follow a sustainable investing approach. The summary table on page 18 should help provide you with clarity on the ways both funds incorporate responsible investment into their investment process and the differences between them.

Choosing between the Rathbone Multi-Asset Portfolios and the Rathbone Greenbank Multi-Asset Portfolios

The chart below illustrates how to take a client's responses to Stage 2 in the responsible investing questionnaire earlier and use them to find a solution which most closely matches their needs.

Would the client like ESG factors to be considered in the investment analysis of the fund?

Yes

Would the client like the fund to vote and engage on relevant ESG issues?

No

A traditional investing approach may be required. However, although the Rathbone Multi Asset Portfolios employ ESG integration and Stewardship, they may still be suitable for a client without any responsible investing requirements if it is discussed with them.

Yes

Would the client like to avoid investing in certain sectors/industries they disagree with or go against their values?

No

A traditional investing approach may be required. However, although the Rathbone Multi Asset Portfolios employ ESG integration and Stewardship, they may still be suitable for a client without any responsible investing requirements if it is discussed with them.

Yes

In addition to avoiding certain industries/sectors, would the client also like all their investments to support or contribute to sustainable development?

No

Rathbone Multi-Asset Portfolios

Yes

Rathbone Greenbank Multi-Asset Portfolios

No

A solely negatively screened fund may be required

		Fund	
		Rathbone Multi-Asset Portfolios	Rathbone Greenbank Multi-Asset Portfolios
ESG integrated investing:	ESG integration	●	●
	Stewardship	●	●
	Negative/ethical screening		●
Sustainable investing:	Best-of-sector investing		
	Sustainability-focused investing		●
	Thematic investing		
Impact investing:	Impact investing		

Matching your clients' objectives to an appropriate responsible investment approach

"I want to make sure any environmental issues which may affect the financial performance of a company have been considered before it is invested in."	**ESG integration**
"It's important that the fund manager has a continuing dialogue with companies on climate change and human rights issues."	**Stewardship**
"I don't want to invest in tobacco or arms companies."	**Negative screening**
"I want to invest in companies which have lower carbon emissions compared to peers in their sector."	**Best-of-sector investing**
"I'd like to make sure all the companies in my portfolio are supporting sustainable development and doing good for the world."	**Sustainability-focused investing**
"All the companies in my fund should be supporting good health and wellbeing."	**Thematic investing**
"I want my investments to make a positive contribution to the world and it's important that the outcomes are measurable and reported to me."	**Impact investing**

Please see pages 8 - 14 for clarity of the definitions for these responsible investment sub-approaches.

5 Busting responsible investment myths

1 ESG integration means giving up performance

This is far from true. ESG integration can and should be pursued by an investor whose sole focus is financial performance.

The focus of ESG integration is to enhance financial returns by uncovering ESG risks and opportunities that might have remained undiscovered otherwise and then investing in companies which are managing them most appropriately. ESG integration has built up a significant track record of providing good returns with multiple studies citing that companies that have good ESG credentials tend to display better operational performance, are more resilient and less likely to experience financial distress.[3]

2 Investing responsibly just involves screening out lots of sectors

There are many different approaches to investing responsibly depending on what the investor aims to achieve.

Negative screening is just one method that is based on avoiding companies that undertake undesirable activities. However, many funds also focus on other approaches. For example, funds undertaking ESG integration and stewardship practices can incorporate ESG factors in the investment process without excluding any sectors at all. Sustainable investing, which although almost always does include negative screening is not limited to this, and also aims to find companies that are leading the way in positively contributing towards important environmental and societal issues such as education and water scarcity.

3 Only millennials and women care about responsible investment

It is often said that the people most interested in responsible investing are the younger generations or women. But this is not necessarily the case.

Environmentalism has been around for decades, with Earth Day first being held in 1970. Research by the Wisdom Council, commissioned by Rathbones, found that the vast majority of people surveyed, not just the young, felt a sense of personal responsibility when it came to environmental issues. Moreover, according to the Schroders 2019 Global Investor Study, which surveyed 25,000 investors worldwide, more than 60% of respondents under the age of 71 said that all investment funds should consider sustainability factors when making investment decisions.

4 Sustainable investment is only appropriate for clients who care about the environment

There is a perception that sustainable investment is only focused on the environment and primarily combatting climate change.

In reality, there are many funds which focus on wider social issues too. This is further reinforced by funds that integrate the SDGs into their investment processes, as this means that they will seek out companies that are making positive contributions to areas other than environmentalism, such as public health, poverty and gender equality. Sustainable investing therefore is appropriate, not only for those who care about the planet, but those who care about people too, and want this reflected in their investments.

3. www.abrabesque.com

6 Deepen your knowledge – key terms to know

UN-backed Sustainable Development Goals (SDGs)

What they are

In September 2015, the United Nations launched the Sustainable Development Goals (SDGs). These comprise 17 goals, with 169 underlying targets that aim to 'end poverty, protect the planet and ensure prosperity for all' by 2030. The SDGs provide a comprehensive framework for international action on the many social and environmental challenges facing the world.

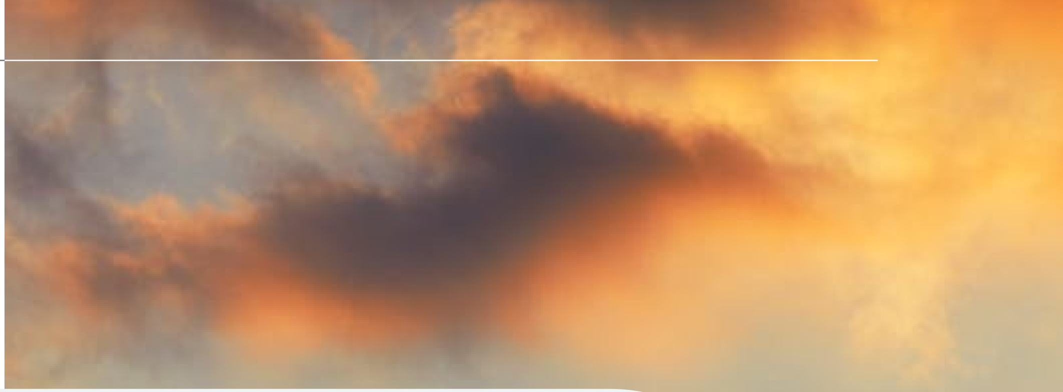
Why they are important

Issues such as climate change, social inequalities, corporate governance and access to health care, education and clean water have become a major focus. The global economy relies on sustainable economic growth and it is believed this will be put at risk if society does not address some of its biggest challenges. The UN SDGs are a framework for solving these problems, which in turn should lead to more sustainable global growth for the long term. While government policy is a part of the equation, action investment from the private sector will be crucial in meeting these goals.

How Greenbank translates the SDGs into eight categories

Greenbank already had a set of eight sustainable investment categories prior to the SDGs being announced in 2015. Their categories ultimately align with the same ambitions as the SDGs but focus on the areas most relevant to companies and investors. We use these to determine how successful individual companies are at translating aspirations into tangible results.

Further information can be found in the Rathbone Greenbank Multi-Asset Portfolios Sustainability Process brochure



Carbon footprint

What is it?

A carbon footprint is the amount of greenhouse gas (GHG) emissions (primarily carbon dioxide) that is released into the atmosphere as a result of a person, company or fund's activities. Nearly everything we do has a carbon footprint to one degree or another.

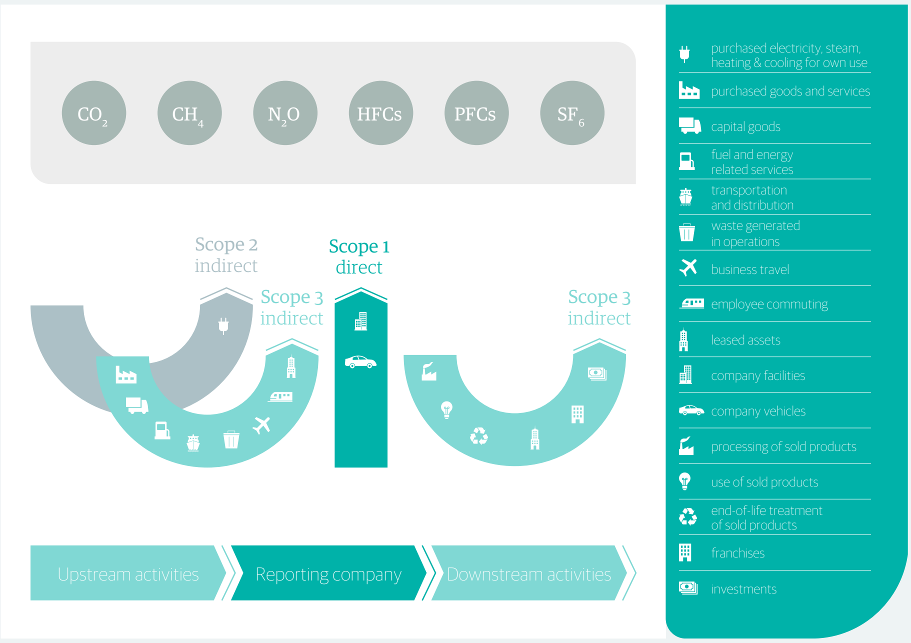
From the food people eat, to the cars they drive and the products they buy, there are carbon emissions associated with most human activities. Some activities have lower emissions than others. For example, locally grown produce sold at the farm will have a smaller carbon footprint than vegetables grown in greenhouses overseas and transported by air freight. A fund also has a carbon footprint and there are several ways it can be measured including:

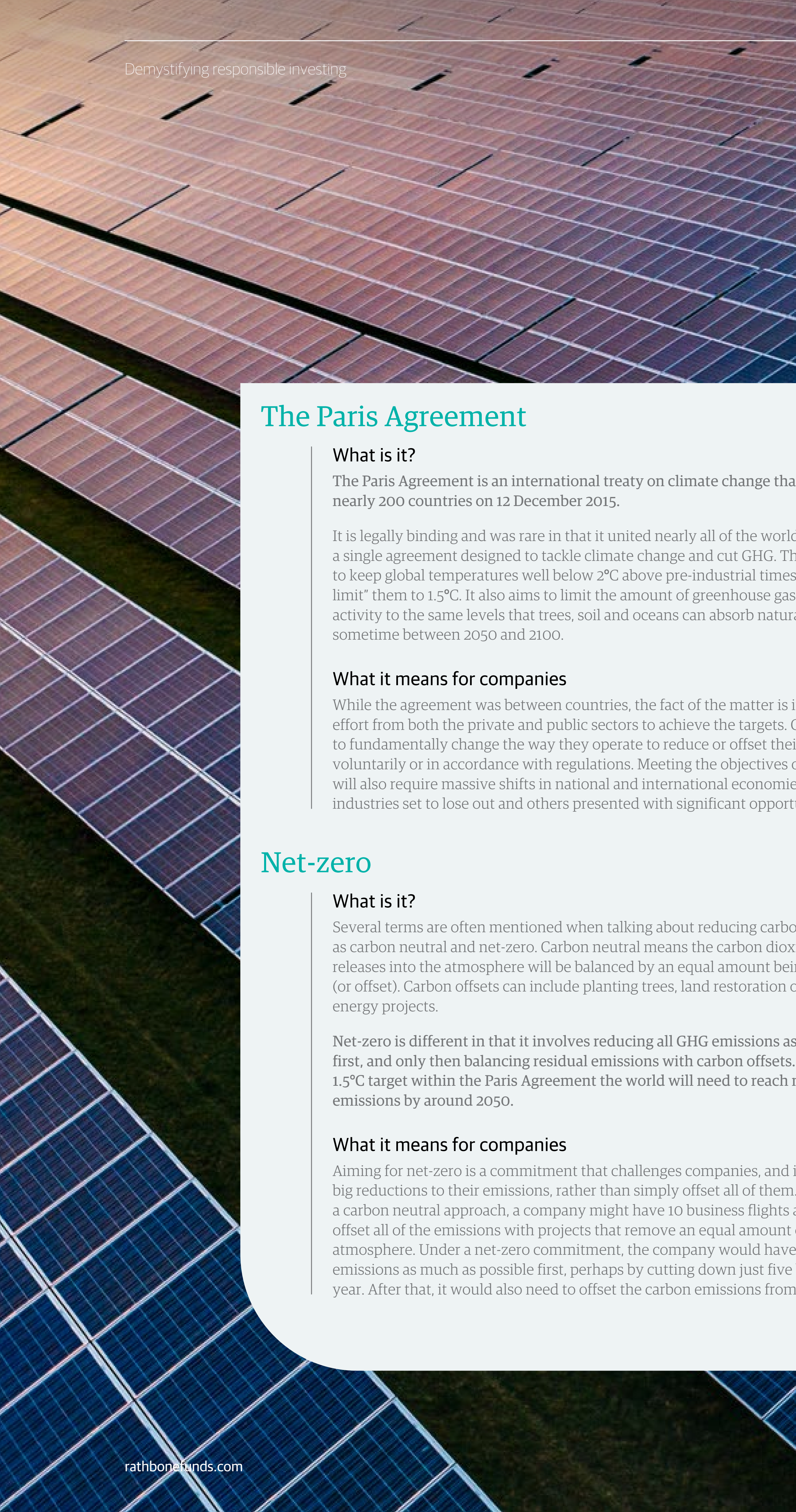
– Total carbon emissions: the total GHG emissions generated by the portfolio
– Carbon intensity: the total GHG emissions generated by the portfolio per dollar of sales generated by portfolio companies.

Scope 1/2/3 emissions

You may encounter the term "Scope 1/2/3 emissions". This refers to the source of emissions associated with a company's activities. Each type of emission falls into one of three categories, or 'scopes', set by the Greenhouse Gas Protocol.

– Scope 1 emissions are direct emissions from owned or controlled sources within a company, such as its own generators or vehicles.
– Scope 2 covers indirect emissions, from the generation of purchased electricity, steam, heating and cooling consumed by the reporting company.
– Scope 3 emissions are all other indirect emissions that arise in its value chain, for example those associated with its supply chain, with the use of its products or through business travel. Scope 3 emissions are often the largest contributor to a company's overall carbon footprint.





The Paris Agreement

What is it?

The Paris Agreement is an international treaty on climate change that was adopted by nearly 200 countries on 12 December 2015.

It is legally binding and was rare in that it united nearly all of the world's nations under a single agreement designed to tackle climate change and cut GHG. The agreement aims to keep global temperatures well below 2°C above pre-industrial times and "endeavour to limit" them to 1.5°C. It also aims to limit the amount of greenhouse gases emitted by human activity to the same levels that trees, soil and oceans can absorb naturally – beginning sometime between 2050 and 2100.

What it means for companies

While the agreement was between countries, the fact of the matter is it will take a concerted effort from both the private and public sectors to achieve the targets. Companies will have to fundamentally change the way they operate to reduce or offset their emissions, whether voluntarily or in accordance with regulations. Meeting the objectives of the Paris Agreement will also require massive shifts in national and international economies, with some industries set to lose out and others presented with significant opportunities.

Net-zero

What is it?

Several terms are often mentioned when talking about reducing carbon emissions, such as carbon neutral and net-zero. Carbon neutral means the carbon dioxide that a company releases into the atmosphere will be balanced by an equal amount being removed (or offset). Carbon offsets can include planting trees, land restoration or renewable energy projects.

Net-zero is different in that it involves reducing all GHG emissions as much as possible first, and only then balancing residual emissions with carbon offsets. In order to meet the 1.5°C target within the Paris Agreement the world will need to reach net-zero GHG emissions by around 2050.

What it means for companies

Aiming for net-zero is a commitment that challenges companies, and investors, to make big reductions to their emissions, rather than simply offset all of them. For example, under a carbon neutral approach, a company might have 10 business flights a year and simply offset all of the emissions with projects that remove an equal amount of carbon from the atmosphere. Under a net-zero commitment, the company would have to reduce its emissions as much as possible first, perhaps by cutting down just five business flights a year. After that, it would also need to offset the carbon emissions from the remaining flights.

7 Navigating ESG fund ratings

As responsible investing has grown in popularity, one buzzword that has emerged is 'greenwashing'. This is when a company or fund's ESG credentials are exaggerated to attract interest from investors and it can apply to companies and funds alike. For example, not all funds labelled as 'sustainable' have the same investment processes and some may invest in companies not traditionally viewed as sustainable, such as oil and gas companies. Therefore, research companies have introduced ratings that make it easier to determine if a fund lives up to its objectives.

ESG ratings can be quantitative and qualitative in nature, measuring how well a fund, and its holdings, are performing against ESG criteria. Each ratings agency follows a different methodology, which means they can produce different results for the same fund. This is because each ratings provider has a different way of looking at a fund's sustainability credentials – some may look at risk and return quantitatively, while others look more deeply at issues such as positive contribution to the SDGs and other ESG activities, such as how much exposure companies in the portfolio have to key ESG risks, how they are governed and whether they have been involved in any controversies.

Each ratings provider offers a unique view of a fund, which can be helpful in determining if it is suitable for a particular client. However, we believe ESG fund ratings do not replace the traditional fund research process. Although they are helpful, it is still important to be sure the way they measure success matches what the client wants from their responsible investment approach.

There are multiple agencies that have ratings for sustainable funds, including:

Morningstar's Sustainability Rating: A measure of the financially material ESG risks in a portfolio relative to a portfolio's peer group

MSCI's ESG Rating: A measure of a fund's resilience to long term risks and opportunities arising from ESG issues

Ethical Screening's Fund Database: A rating system assessing a fund's ethical and environmental credentials across four areas including exclusions, oversight, ESG and impact to help cut through greenwashing and match a fund to a client's chosen ethical criteria

Square Mile Research ESG Assessments and Responsible Ratings: A range of accreditations from ESG to impact designed to evaluate how and if a fund is meeting its responsible investment objectives

RSMR (Rayner, Spencer, Mills Research)'s Responsible Fund label: An evaluation of both the firm and fund sustainability credentials to determine if a fund can be labelled as ethical, sustainable, thematic or impact

Did you know?

58% of investors who have a financial adviser have considered responsible investing.[4]

4. Source: The Wisdom Council 2020 research programme

8 How to identify greenwashing

Ultimately, it is important for advisers to do their own research on any given fund to ensure it is suitable for a client and will meet their specific needs, rather than rely solely on third-party ratings.

The answers to these questions will provide you with some insight into whether the funds being offered meet your clients' expectations.

So what should you investigate?

1

The firm's history and credentials in responsible investment:

- Does it have a track record in this area?
- Is it signed up to the Principles for Responsible Investment? or the UK Stewardship Code?
- Does it make its responsible investment, shareholder voting and company engagement policies public?
- Does it have a dedicated sustainable research team and process for analysing companies and other securities?

2

The firm's history regarding sustainable fund launches:

- Has the firm rebranded existing funds as sustainable with little change to the investment process or objective, or has it launched dedicated sustainable funds?
- Has the personnel on the fund changed as a result of the changes?
- Has the investment process changed or is it the same as before?

3

The fund's responsible investment criteria:

- Does the firm outline its responsible or sustainable investment process for the fund in detail and is it clear and transparent?
- Which responsible investment approach does the fund follow – ESG integrated, sustainable or impact?
- Have they incorporated sustainability considerations across all their asset classes, or just the equities?
- Is the fund heavily reliant on third-party ratings or does it utilise in-house research?
- Do they only use negative screening to exclude companies, or are they using positive criteria to find the best performers?
- Does the investment process include a deep dive into how companies operate and what their supply chains look like?
- Does the fund have a voting policy and clear active engagement approach?

4

The fund's holdings:

- What kind of companies does it hold? Do they make sense in a sustainable fund? Do they give you confidence in the responsible or sustainable investment process?
- Will they provide you with a complete list of portfolio holdings and not just the top-10 or a subset?
- Does the firm have an external or arms-length research team that can analyse or reject prospective investments from going into the fund?

9 Glossary

Best-of-sector Investing	A form of responsible investment which looks at relative ESG performance within specific industries or sectors. Preference is given to companies displaying better environmental, social and governance standards relative to their peers.
Carbon footprint	The amount of carbon dioxide/greenhouse gas emissions that a company, organisation or the holdings of a fund release into the atmosphere.
Corporate governance	The way in which a company behaves and is managed. This includes the structure of a company's leadership, including the board of directors and senior management teams, and how it approaches executive pay, employee relationships and shareholder rights, among other matters.
Engagement/ advocacy	The process of working with organisations, industry bodies or policymakers to address issues of concern and bring about positive change. It encompasses many approaches, for example: meetings with senior management; public statements; collaboration with other investors; and tabling or voting on resolutions at company AGMs.
Environmental (the 'E' in ESG')	Considerations relating to the quality and functioning of the natural environment. These include climate change, biodiversity loss and pollution.
ESG integration	The systematic and explicit inclusion of material environmental, social and governance (ESG) factors (e.g. environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters) into investment analysis and investment decisions.
Impact Investing	An investment approach which intentionally targets investments that generate positive, measurable social and environmental impact alongside a financial return.
Governance (the 'G' in ESG)	Considerations relating to the governance of companies and other investment vehicles. For listed equities these include: board structure and effectiveness, executive pay, business ethics, bribery and corruption and risk management. This category may also include matters of business strategy relating to environmental and social issues.
Greenwashing	Conveying a false impression or providing misleading information about a company or fund's true sustainability credentials.

PRI	The UN-backed Principles for Responsible Investment is a global initiative committed to advancing responsible investment through its six aspirational principles.
Negative/ethical screening or exclusions	Restrictions on investment in particular stocks or sectors, or in companies that are involved in specified activities or behaviours.
Net-zero	A state in which the greenhouse gases going into the atmosphere are balanced by removal out of the atmosphere.
Responsible investing	The purposeful integration of environmental, social and corporate governance (ESG) considerations into investment management process and ownership practices in the belief that these factors can have an impact on financial performance.
Social (the 'S' in ESG)	Considerations relating to the rights, well-being and interests of people and communities. These include human rights, employment practices, inequality and basic needs.
Stewardship	The responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.
Stewardship Code	A set of standards that outlines the expectations for asset managers and asset owners. The codes are usually set by local regulators in each country. In the UK, the UK Stewardship Code is a law that underlines the principles that institutional investors are expected to follow. It is managed by the Financial Reporting Council with the goal of making institutional investors be proactive and engage with stakeholders.
Sustainable development goals (SDGs)	A set of goals seeking to end poverty, protect the planet and ensure prosperity for all by 2030. Adopted by world leaders at a UN summit in 2015, the SDGs consist of 17 top-level goals and 169 underlying targets. These cover issues such as nutrition, poverty, biodiversity and climate change, with many goals interconnecting.
Sustainability-focused Investing	Aims to invest in companies and entities which are supporting sustainable development; through their operations or by providing goods/services that benefit people and the planet today without compromising their future needs.
Sustainable Investing	Targets investments which contribute to positive environmental and social objectives, alongside good governance practices (and without incidence of significant harm) thereby supporting progress towards a more sustainable world.
The Paris Agreement	A legally binding international treaty on climate change adopted by 196 parties at COP 21 in Paris where the goal is to limit global warming to well below 2, preferably to 1.5°C, compared to pre-industrial levels.
Thematic Investing	Investing in line with a specific theme, or set of themes, that seek solutions to social or environmental challenges.

Get in touch

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