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A Guide to Sustainable and Responsible Investing

2014

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Introduction

A decade or so ago ethical or sustainable and responsible investing (SRI) might have just involved an investor asking their adviser to exclude any funds with holdings in the tobacco or arms industries and the adviser would have been left to complete their research without recourse to any impartial assistance.

Today, the area of ethical investing or SRI commands a much more professional approach. The investment community's understanding of the importance of sustainability issues has improved and fund choice has grown significantly. As a result investors are able to demand greater sophistication and expect to find funds that meet both their financial and their SRI goals.

Although the market is dominated by institutional funds, the value of UK retail funds estimated as at 30th June 2013 was some £12.2bn – up from £4bn 10 years ago according to research provider EIRIS and this is not only a UK or European phenomenon, the appeal of the United Nations backed Principles of Responsible Investment initiative indicates its growing international support, having attracted over 1200 signatories with assets valued in excess of $30 trillion since its creation in 2006.

As part of this transformation we are now seeing green and ethical investment embraced by pension funds, insurance products and ISAs. With such a wide breadth of SRI options available, a growing cross-section of society is investing in such options as they provide the ability to invest in a way that suits their personal aims – which often include wanting to make a difference on social or environmental issues as well as wanting to achieve a decent return.

But questions remain for advisers, such as:

- Have adviser propositions evolved to reflect this growing interest within their Treating Customers Fairly (TCF) obligations?
- Is there a practical process or model for advisers to adopt?
- How to select funds that will meet clients' SRI criteria whilst also being robust from an investment process perspective?

For some individual investors details of a fund's SRI strategy can play an important part in where they may choose to invest. Others may be less interested.

Clients who are interested in responsible investing can have highly diverse goals. As such green and ethically minded investors cannot be seen as an homogenous group any longer and in fact the funds available today are far from homogenous. This presents a challenge for advisers. Not only must they ensure that the funds selected meet the clients specific SRI aims, but they must also aim to ensure that financial and risk related objectives are met.

The increased sophistication of this area has meant that many advisers have avoided this issue whenever they can, feeling that it is too difficult to find appropriate funds.

This guide brings together the knowledge and expertise of two companies which approach ethical and 'sustainable and responsible' investment from different perspectives.

Here at Rayner Spencer Mills Research we have been assessing and rating retail investment funds for financial advisers for many years and Julia Dreblow of sriServices has worked to develop and promote the ethical and SRI market since the 1990's.

By drawing on both sets of experience and bringing together two different but complementary viewpoints this unique guide addresses the three main challenges of advising in this area:

- understanding what is available
- working out how to integrate SRI into the advice process
- selecting appropriate fund options.

The guide offers an introduction to how the SRI market works – including how to segment funds by their approach to SRI and suggests an SRI advice process. It concludes with a pre-researched list of funds that have come through the RSMR analysis process – all of which are classified according to the sriServices 'SRI Styles' system.

For each of the funds included, we have put together a detailed fund factsheet now including our new SRI Rated Fund designation. These factsheets summarise the fund information together with comment on the fund management process, and also our opinion on the fund and how it could be used.

Rayner Spencer Mills R SRI RATED FUND

We have now introduced a separate rating for those SRI funds that have met our criteria. This enables us to rate funds which may not be suitable for our mainstream rated fund list, but are strong funds within the SRI universe. You will find the SRI Rated Fund logo appears on our factsheets and also on literature from the relevant fund groups.

Incorporating SRI into the advice process can bring a range of benefits to advisers. It can help enhance their overall Client Service Proposition, offer a potential point of differentiation, help build stronger client relations and enhance TCF propositions. It will also help those advisers who are working towards achieving the Adviser ISO (ISO22222) and related British Standards certification schemes which include the requirement for advisers to discuss SRI aims. All of which means that a robust investment selection process, including an assessment of SRI requirements, is increasingly viewed not only as bringing business benefits – but also as an indicator of best practice.

Richard Essex Financial Planner at Grayside FS says:

"At Grayside we actively promote the concept of socially responsible and ethical investing and we have found many of our clients respond positively when this is discussed at our meetings. Over the last 2 years we have developed an approach to ensure we discuss this concept with all clients and we are able to utilise the portfolios that RSMR have created for us.

The addition of new funds to the RSMR list will broaden our choice and introduces new managers to the range available. Also, as RSMR have extended their formal 'Ratings' to SRI funds we feel sure this will create further opportunities for promoting the SRI concept which can only be good for advisory firms and clients alike."

This Guide is part of an evolving service for advisers brought to market following the collaboration of RSMR and sriServices and we hope you find it useful. For more information about RSMR and sriServices, please see the appendix to this report and visit our websites.

This guide can be used as part of your CPD requirements.

The SRI Market

In the past, ethical investing and SRI have been seen as being on the peripheral of mainstream advice, often regarded as the remit of specialist advisers and only for a small client segment with specific requirements in this area. Clients interested in this type of investment were expected to have clear ideas of what they would and would not invest in and to be satisfied with a small range of funds intended to cater for their needs.

A number of factors have combined to change this. The growing awareness of environmental issues such as climate change, together with an increasing understanding of the importance of social issues have meant that more and more clients are interested in reflecting these issues in the way they invest. Not to be confused with the often misleading stereotype of the early 'ethical investor' these new more diverse 'responsible investors' commonly want to invest positively and also expect to achieve decent investment returns.

As part of UKSIF's National Ethical Investment Week 2013 research was conducted by YouGov* which found that:

- Almost two thirds (63%) of British investors would like to be offered a sustainable and ethical option when choosing investments;

- Two thirds of people would like to be offered the option to choose a sustainable and ethical pension product – particularly interesting with auto-enrolment into workplace pensions being rolled out over the next few years.

There is also concern that unsustainable business practices could put investors' money at risk:

- 67% of respondents would be concerned about losing money if it was invested in companies pursuing activities that could be unsustainable in the long term;

- 43% would be likely to move their money out of a company that engaged in unethical or unsustainable activities.

- 34% of investors surveyed said they want their savings and investments to help build a sustainable UK economy, and the following are the top 5 issues they would be most interested in supporting:
    - Renewable energy – 42%
    - Energy efficiency – 40%
    - Healthcare and access to medicine – 39%
    - Waste and recycling – 39%
    - Sustainable agriculture and fishing – 38%

Although there is a clear demand for ethical and sustainable financial products, people could be held back by a lack of information and assistance:

- 74% of those surveyed did not know where to get advice about sustainable and ethical investments

- 64% were not aware that there are sustainable and ethical investment options available for all types of investment product.

It would seem therefore that many investors recognise the importance of SRI as an investment strategy and are likely to welcome advice in this area.

Whilst accepting this approach it is reasonable to accept that some investors may see this as core to their strategy whilst others will only seek exposure to SRI funds for a part of their portfolio.

It is diverse views such as these that an adviser needs to draw out during the fact finding process so that they can be fed through into their investment recommendations. By doing so advisers can integrate sustainable and responsible investment aims into investment strategy and so respond to clients' aim to meet both financial and other often less tangible goals.

* Source – UKSIF – with thanks for their permission to quote this research.

UKSIF

Rayner Spencer Mills & sriServices are members of UKSIF

Introduction to SRI

SRI can be defined as 'any investment that takes significant account of social, ethical, environmental or governance issues' no matter what asset type or investment vehicle it falls within. In the retail investment market 'SRI' is often used interchangeably with the term 'ethical investment', although the latter is more appropriate for fund options which focus significant attention on ethical issues (see below).

Interest in SRI is growing as matters of this kind are increasingly viewed as important both to business and to our everyday lives. A number of them are also viewed as increasingly likely to impact on investment returns over the coming years.

Example SRI Issues

Environment

Environmental challenges, such as; climate change, pollution, biodiversity, environmental management, waste, the use of natural resources – including water, forestry, mining

Social

Issues that relate to people, such as; human rights, labour standards, child labour, equal opportunities, food supply

Governance

Issues relating to company management, such as; board structure, executive remuneration, bonuses, avoidance of bribery and corruption

Ethical

Values based and ethical concerns, such as; Tobacco, armaments, pornography, alcohol, irresponsible marketing or advertising, animal welfare

The number of SRI issues a fund considers can have a significant impact on where it might invest. Yet it is how those issues are dealt with, referred to as a fund's 'SRI approach' that often has a greater impact on investment strategy.

This means it is not possible to work out where a fund might invest (or who it might be appropriate for) simply by knowing which issues it considers. To start this process it is necessary to understand the funds 'SRI strategy' which includes both the issues it considers and the approaches it applies to those issues.

There are a range of approaches that can be taken to investing, with different funds operating in different ways. The main approaches which can be combined in many ways are outlined here.

SRI Approaches

Responsible Engagement (or 'engagement') involves using investment ownership to encourage progress on environmental, social or governance (ESG) issues where there is a business case for encouraging change.

Engagement involves using dialogue, voting and responsible shareholder activism to encourage positive change and to help reduce ESG risk. Such activity relates to assets that are already held – rather than stock selection decisions.

Engagement can be integrated across a fund manager's entire investment portfolio (or particular asset types e.g. equities) – or it may only apply to a specific fund alongside other SRI approaches, such as ethical screening or a thematic investment strategy.

Thematic investment and positive screening strategies both involve directing investment towards companies (or other organisations) that meet a fund's 'positive' SRI objectives. Such a fund may set out the themes or business attributes it considers to be positive, beneficial or desirable – such as helping us to make the necessary shift towards more sustainable lifestyles – and invest accordingly.

Impact on investment decisions can vary significantly. Some funds focus on a single sector or issue, whereas others are broad based – focusing on a range of longer term challenges and opportunities that face business. Some invest in a narrow range of industries; others invest widely in companies that achieve certain standards. Themed funds such as Environmental funds and Sustainability funds generally have positive approaches of this kind – although some also have areas that they avoid. Screened ethical options may also apply this approach to some areas.

Avoidance or 'negative screening'. Avoiding companies (or other investments) that are involved in activities that a fund manager has defined as 'unacceptable' or 'unethical' is a major feature of ethically screened funds.

Negatively screened ethical funds typically have a list of business practices that are considered to be unacceptable and set exclusion criteria to reflect these views. Negative screens and other exclusion criteria often relate to values based ethical issues but may also relate to environmental, social or governance issues.

The impact on investment strategy varies from fund to fund. Some funds exclude companies with only minor involvement in excluded activities whereas others are less strict and balance the positive benefits of companies against their negative attributes.

The way in which issues and approaches are combined varies greatly and there is now a wide range of options available to investors. The issues that are important to investors can also change over time, for example e-cigarettes, fracking and arctic drilling are emerging issues that are now being considered by some managers.

Although there are no hard and fast rules about how these funds should be grouped together, they can be clustered into a small number of 'SRI Styles' based on their approach to ethical, social and environmental issues. These are outlined in the following section of the guide to help advisers identify relevant options for their clients.

For a more detailed introduction to SRI strategies see **www.sriServices.co.uk/about-sri**

It is of course important to remember that SRI factors are not the only relevant aspects of SRI investment strategies. Generic factors impact SRI funds as much as they do any other fund. Factors such as asset types, the market capitalisation of the stocks held, geographic spread and timing affect all funds – as do investment aims (e.g. growth or income), benchmarking decisions, fund manager skill and charging structures.

For an adviser to recommend an SRI fund they need to understand both 'generic' and 'SRI' factors – as neither offers a complete picture on its own. In this guide, we have considered both these aspects to put together information and a suggested fund list that is robust and user-friendly.

Fund manager SRI information sources

For investors who are interested in SRI there are two types of information supplied by fund managers that may be of use:

Information about the fund management company which sets out any specific or companywide responsible investment, engagement or corporate responsibility related activity. Information of this kind paints a picture of the kind of company a potential investor is investing through.

Fund specific information – which sets out where an investor's money will be invested and how any published ethical, social or environmental themes or screens work.

There is a lot of debate around the performance of SRI and ethical funds. Much of this commentary works on the basis that green and ethical funds are broadly similar, which is unhelpful given the variety that we know exists.

The IMA compares 'ethical' funds with others on occasions and their approach is broadly pragmatic. They have long since commented that there is no significant difference between these and other funds – which may account for the continuing debate as, like other investments, some funds do better than others and performance varies over different time periods.

In thinking through how to view this market advisers may find it useful to consider how it is dealt with elsewhere. Across the institutional and pensions markets the debate has largely moved on. Many major investors are looking at how best to integrate Environmental, Social or Governance (ESG) factors into investment strategies – not whether or not to do so. Engagement strategies are widely used and full ESG integration across mainstream portfolios is increasingly popular – primarily for risk mitigation reasons. Funds that focus on ethical issues are generally viewed as more appropriate for individual investors or organisations with defined value sets.

Advisers may also wish to consider the benefits of funds using ESG research that is often missed by other fund managers. So even where an SRI strategy reduces investment choice funds may benefit from deeper company analysis and stock selection.

Integrating SRI into the advice process

Integrating sustainable and responsible investing into the normal advice process is not complex. The first step is to introduce an appropriate question into the fact find which will identify whether or not it is an area to be pursued.

For an adviser who is talking with an interested client their first step must be to understand which aspects of SRI are of interest to their client – and why. Different discussions may ensue with different clients. Some may be drawn to SRI because they have a view of the performance benefits of particular strategies, others may be for reasons of personal values or beliefs.

The following diagram summarises the key steps in the SRI advice process:

Step 1

Initial SRI Fact Find Question
Action: Ask as part of your regular fact finds – 'Are there any social, ethical, environmental or religious issues you would like to take into account while considering where to invest?'

Step 2

Identify SRI Aims
Action: Carry out additional SRI fact finding to find out which areas are of interest to your client.

Step 3

Combine SRI and Regular Fact Find information
Action: Consider SRI Aims alongside other investment & product goals as identified during the main fact finding process. Consider the balance between SRI and other aims.

Step 4

Identify preferred options
Action: Carry out (or outsource) due dilligence and research on relevant fund options.

Step 5

Recomendations
Action: Discuss options with clients and make recommendations

Step 6

Review
Action: Agree and implement review schedule

This can be broken down further into the key actions that have to be considered for each stage in the process:

Pre Meeting

- Include an SRI fact find question in your standard fact find to identify which clients are interested in SRI. (The question in step 1 above meets the adviser ISO requirements).
- Set up a process for identifying clients' SRI aims (eg SRI fact find questionnaire)
- Set up a system for combining clients' SRI aims with their other financial needs as identified during the fact finding process.

Client Meeting

- Identify and document client SRI aims, focus on areas of greatest interest to client.
- Consider SRI aims alongside relevant financial, risk, compliance and TCF considerations to start thinking through relevant options and combinations.
- Consider the balance between SRI (including 'responsible engagement') and non-SRI options remembering it may be appropriate to 'mix and match' the two.

Post Meeting

- Check your audit trail is complete – document SRI aims and how they filter through to relevant investment options.
- Consider what additional SRI related situations may trigger a client review and set up data feeds/information sources for information updates if required.

Whether or not a client should invest in a particular themed, screened or responsible engagement fund will depend entirely on their situation. For some individual investors details of SRI strategy can play an important part of where they choose to invest. Others may care more about other factors. In either case an adviser should ask an initial 'SRI fact find question' as part of their regular fact finding process and be able to deal with clients who express an interest. Indeed being able to do so is now regarded as 'best practice' and is a requirement of ISO (ISO22222) and the related certification schemes BS8577 and BS8453 – meaning that in order to achieve such standards advisers must discuss this area with their clients.

This means an adviser needs to know enough about SRI options to be able to talk around the subject and offer appropriate advice. The growing interest in SRI issues also means this can open up opportunities for business.

Additional Help

sriServices offers a free on-line 'Fund EcoMarket' database tool for advisers via www.FundEcoMarket.co.uk . The tool is designed to help with Steps 2 & 3 of this process and allows advisers to identify SRI funds that are available within specific product and investment areas with funds grouped by their SRI style.

The tool includes an optional client 'SRI StyleFinder' fact find questionnaire to help advisers identify the SRI style or styles a client is most likely to be interested in.

All entered data can be saved to pdf or printed in report form for use by the adviser as part of their audit trail.

Choosing Funds – SRI Styles

Having established that SRI options should be considered, the adviser then needs to move on to selecting funds. This can be complex, given the diversity of funds available, and so we start by looking at the types of funds in the market today, and categorising them so that they can be compared and then matched to client preferences.

SRI funds consider a diverse range of ethical, social, environmental and governance issues which they approach in many different ways. Some funds focus on ethical values, some concentrate on business and societal risks and opportunities – others combine the two. All aim to maximise performance within the terms of their SRI strategies.

SRI strategies vary because fund managers have different views and objectives – and of course different funds are intended to target different investors.

Working out which funds are likely to appeal to which clients can be complex if the adviser chooses to review each issue and approach individually. To help make the SRI market easier to understand sriServices have developed a system of 'SRI Styles'. These Styles segment the major retail SRI fund options into groups that have broadly similar SRI aims and strategies.

'SRI Styles' relate to a fund's dominant SRI characteristics (issues and approaches), not their investment strategies – which are best considered separately.

There are areas of crossover between many of the SRI Styles, for example most funds consider environmental issues, not just environmental funds and most avoid significant exposure to tobacco and armaments either as a result of implicit or explicit avoidance strategies. It is therefore important to focus on the dominant features and where appropriate consider more than one SRI Style.

An adviser will find it useful to talk about these Styles as they reflect the most common fund strategies and also the most common client aims although checking fund specific details is valuable for many clients.

The eight major SRI styles that are available to individual investors are illustrated below:

Responsible Engagement

Sustainability Themed

Balanced Ethical

Environmentally Themed

Negative Ethical

Faith Based

Clean Technology

Specialist

We now look at these 'Styles' in a little more detail:

Responsible Engagement Funds

Responsible Engagement funds are regular funds which employ a range of dialogue and voting based strategies to encourage better business practices across both institutional and retail investment assets. This strategy aims to enhance investor returns by encouraging more responsible, forward looking business practices and better risk management. Such activity is normally carried out by specialist environmental, social, or governance (ESG) analysts, who may be employed in-house or by an external agency. Their decisions do not normally drive stock selections although analysis of this kind is increasingly being integrated into fund management practices.

See 'Our SRI Rated Funds' section later in the guide for a list of fund management groups from our Rated Fund Service that offer funds within the 'Responsible Engagement' style.

Sustainability Themed Funds

These funds focus on the sustainability agenda when considering where to invest. Strategies vary – some funds focus on specific issues or industries (e.g. water, health, education, transport, resource scarcity) whereas others hold 'best in sector' companies across all (or most) industries. Sustainability themed funds typically hold forward-looking companies, with strong or market leading credentials and favour companies that are well placed to benefit from regulatory, legislative and societal change.

Balanced Ethical Funds

Balanced Ethical funds are ethically screened funds that balance the positive and negative aspects of company behaviour across a range of ethical, social and environmental issues. They are likely to combine a number of SRI approaches, invest in most sectors and favour well managed market leaders or 'best in sector' companies – whilst avoiding laggards. They tend to be less 'strict' (sometimes termed 'lighter green') and have fewer absolute negative exclusions than 'Negative Ethical' funds.

Environmentally Themed Funds

Environmentally Themed funds significantly integrate environmental opportunities and risks into their investment decisions. Environmental funds may focus on a range of environmental themes or specialise in a single issue relating to areas such as climate change or resource scarcity, favouring companies with market leading strategies. Some environmental funds consider social and ethical issues alongside environmental criteria.

Negative Ethical Funds

Negative Ethical funds' primary approach is the strict avoidance of a range of activities that do not meet more traditional, ethical or 'values based' standards. They are likely to also screen according to environmental and social criteria, excluding companies that do not meet the fund's policies. They may have positive selection criteria but these do not override the fund's negative screens. These funds tend to explicitly avoid more companies than any other approach.

Faith Based Funds

Faith Based funds are an emerging but very limited group of funds that invest in line with a specific set of religious values. This style has similarities with the more traditional Negative Ethical options as their core focus is avoidance.

Clean Technology Funds

Clean Technology funds specialise in market leading clean technology and environmental solutions companies. Fund managers often focus on environmental markets and may favour smaller pure-play companies that are well placed to lead change. These funds tend to invest in companies where their environmental solutions expertise is the mainstay of their business. These are thematic funds and do not have ethical screening criteria.

Specialist SRI Options

Specialist Options include investments which fall within the broad definition of SRI but do not fit within the classifications shown above. These may be investments that have been designed to meet a specific challenge, such as 'Impact Investments' which target specific social, ethical or environmental outcomes. Regulatory issues often make it difficult for advisers to support such options so most are not currently considered or listed within the sriServices Fund EcoMarket database tool.

Choosing Funds

Having considered the SRI Fund 'Styles' outlined in the previous section the aim of the fund selection process used to create our list of SRI Rated Funds for this guide is to provide a range of quality SRI options spanning these various 'Styles' from a range of fund management groups.

This process is based on the methodology that we use for all our fund analysis (a copy of which can be found as an appendix to this document) amended slightly to take account of the range of funds available and their specific characteristics.

The process used can be summarised as follows:

Initial Fund Universe	Initial Fund Filter	Research	Final Fund List
• Onshore Unit Trust/OEIC funds • Other relevant funds with specific SRI focus	• Exclude funds without a retail investor focus (e.g. Charity funds) • Initial statistical screen to filter out consistently poor performing funds • Include funds from companies with a strong embedded SRI philosophy • Group funds by SRI Style	• Information about the overall investment process • Information about the individual fund's SRI policy and approach	• Select funds of sufficient quality covering a range of asset classes and geographical regions, listed by SRI Styles • Award SRI Rated Fund designation

Defining the fund universe

The first part of the process is to determine the initial investment fund list on which to conduct further research. Our starting point is the onshore Unit Trust and OEIC universe, filtering all funds so that only those with a specific SRI/ethical focus are identified. Offshore funds could also be considered but only those with FCA Recognised status and listed within an IMA sector. In order to ensure we compare funds with their peers, we then group the funds by their SRI style before the next stage.

Quantitative Research

A number of filters are then applied to the initial fund universe. As this guide is for retail investors, we only consider funds with a focus on the retail investor, which means that we exclude certain funds such as charity funds and also those funds with a high minimum initial investment amount.

The next stage is to then apply a series of statistical screens, looking at a range of performance and risk measures. Here we are looking to exclude the funds that have performed badly, and also to better understand the risks being taken and how this affects the performance of the funds. Given the range of funds considered, each is looked at in the context of its IMA sector and its SRI style, thereby ensuring that we compare a fund with its appropriate peer group.

More detail on the quantitative screens applied can be found in the methodology in the appendix.

Qualitative Research

The qualitative research is arguably the more important part of the process. Here we look at the fund as a whole, with the purpose of understanding how it works in detail, and how its objectives and fund process relate to the performance and risk we have seen in our quantitative research.

The qualitative assessment is based on a thorough understanding of the fund. Much of the information is obtained through a detailed questionnaire completed by the fund management group, but we also obtain information from a variety of other sources.

In this part of the process, we consider how the fund is run, the resources in place to manage the fund and the expertise of key individuals. We also look at how the fund management team make stock decisions, and what risk measures and controls are in place. Again, more detail on this can be found in the methodology document.

It is important to note that our methodology allows the flexibility to include funds that have not met the risk or performance criteria we set. This is important in many areas as a fund may be run in such a way that means it will have periods of underperformance, or it may be in a sector to which it is not really comparable. Our process is to understand the fund, and understand why it has performed in the way it has. Where we can see clear reasons for any underperformance, and still see reasons for using the fund, then it may still be included.

This flexibility is particularly important in the area of responsible investing as the funds will, by their nature, have a more limited universe of stocks to select from, and may also be subject to other constraints that could affect their performance. A strong fund process and well defined stock selection criteria together with a commitment to the SRI market can override the other qualitative criteria.

Responsible Engagement Funds

In the previous section, we outlined what responsible engagement options are, and how they operate. As this strategy typically forms part of a fund manager's regular investment management processes we have included a list of the fund management groups who operate in this way along with a list of the asset types this SRI strategy relates to. Advisers should visit our website (www.rsmgroup.co.uk) to identify the funds that we currently rate from those managers.

Final SRI Rated Fund List

The final fund list comprises those funds that we feel are well run and have a robust, repeatable process which has resulted in performance in line with expectation and with the risks taken.

The purpose of this is to provide advisers with a usable list of funds, all of which have met a minimum standard. It is important to note that there will be other funds outside this list that may be suitable, depending on the risk profile of the client and their specific needs and preferences.

In compiling the list, we have taken into account a number of additional qualitative factors. Clearly a different set of factors would have resulted in a different set of funds and advisers must ensure that they understand the process we have gone through in constructing this list, and that this fits with their sales and advice process and is suitable for their clients.

The funds are all given our SRI Rated Funds designation.

Rayner Spencer Mills SRI RATED FUND

When considering using SRI funds, it is worth taking a view of a fund's SRI strategy and considering how any differences between that fund and its non-SRI peers may impact returns over the likely lifetime of the investment. This may include considering for example, whether sustainability issues are likely to become more or less important (and therefore useful) over that timescale, or how focusing on (or avoiding) particular sectors may impact performance or risk. The conclusions drawn should then be matched with the level of interest expressed by the client and their individual aims.

Our SRI Rated Funds

We have reviewed the SRI funds according to the methodology outlined in the previous section, and those that have met our required standards have been awarded our SRI Rated Fund designation. A summary of the funds that we currently rate, grouped by their SRI category can be found in our SRI Matrix which is available on our website. Also available are detailed factsheets on each of the rated funds.

RSMR SRI Rated Funds

For an up to date list of all the funds currently rated from these providers, please go to www.rsmgroup.co.uk where you can also access fund information to help you select the most appropriate fund. Relevant entries also appear on Fund EcoMarket indicating where engagement options should be available within direct product and asset types. Both lists are subject to regular review and will change over time.

Style	Fund Management Company	Fund Name	OCF*	IMA Sector
Balanced Ethical	Aberdeen	Ethical World	1.13	Global
Balanced Ethical	Ecclesiastical	Amity European	0.92	Europe Ex UK
Balanced Ethical	Ecclesiastical	Amity UK	0.87	UK All Companies
Balanced Ethical	Ecclesiastical	Amity International	0.83	Global
Balanced Ethical	F&C	Stewardship Income	0.81	UK Equity Income
Balanced Ethical	F&C	Stewardship International	0.78	Global
Balanced Ethical	Rathbone	Ethical Bond	0.71	Sterling Corporate Bond
Balanced Ethical	Royal London	Ethical Bond	0.51	Sterling Corporate Bond
Clean Technology	Allianz	Global Eco-Trends	1.59	Specialist
Environmental Themed	Jupiter	Ecology	0.8	Global
Environmental Themed	Schroder	Global Climate Change	0.98	Global
Negative Ethical	Kames	Ethical Equity	0.81	UK All Companies
Negative Ethical	Kames	Ethical Corporate Bond	0.57	Sterling Corporate Bond
Negative Ethical	Kames	Ethical Cautious Managed	0.83	Cautious Managed
Negative Ethical	Standard Life	UK Ethical Equity	0.9	UK All Companies
Responsible Engagement	SVM	All Europe SRI	1.19	Europe Inc. UK
Sustainability Themed	Alliance Trust	Sustainable Future Absolute Growth	0.85	Flexible Investment
Sustainability Themed	Alliance Trust	Sustainable Future European Growth	0.85	Europe Ex UK
Sustainability Themed	Alliance Trust	Sustainable Future Global Growth	0.85	Global
Sustainability Themed	Alliance Trust	Sustainable Future Managed Growth	0.85	Mixed Investment 40%-85% Shares
Sustainability Themed	Alliance Trust	Sustainable Future UK Growth	0.85	UK All Companies
Sustainability Themed	Alliance Trust	Sustainable Future Corporate Bond	0.6	Sterling Corporate Bond
Sustainability Themed	First State	Worldwide Sustainability	1.16	Global
Sustainability Themed	Sarasin	Equisar – Socially Responsible	0.98	Global
Sustainability Themed	WHEB	FP WHEB Sustainability	1.07	Global

NOTES

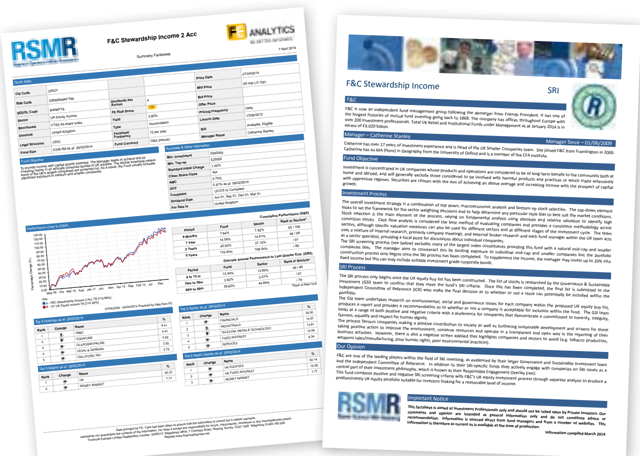
The following Fund Management Groups have funds on the Rayner Spencer Mills Rated Fund Service that apply Responsible Engagement strategies to the following asset types: Aviva, who engage on all equity assets - F&C, who engage on all equity, bond and property assets - First State, who engage on their equity, fixed interest and property assets - Jupiter, who engage on all equities and some bonds - Standard Life, who engage on UK equity and property assets

(source – sriServices Fund Manager Survey – all information correct at time of going to press)

Note – Due to the restricted fund range available, we do not currently rate any specialist or faith based funds.

Factsheets

Factsheets are available on all our SRI Rated Funds.



These can be downloaded from our website – www.rsmgroup.co.uk.

Portfolio Construction

This guide is primarily focussed on the inclusion of an element of responsible investment as part of a client's overall portfolio and we feel the choice of funds aligned to the various SRI Styles will allow advisers to recommend an SRI strategy with greater confidence and competence.

If you require a set of SRI portfolios, please contact us on 01535 656555 or email enquiries@rsmgroup.co.uk with details and we will be happy to provide an indication of the costs involved.

Conclusion

This guide brings together a wealth of information and tools to provide a totally independent view on SRI as an investment strategy, together with an independent analysis and rating of SRI funds.

In spite of the many challenges facing all investment markets over recent years the SRI market has continued to grow and even demonstrated significant outperformance against 'mainstream peers' in some years. As a result there are many different ethical, social and environmental issues that can now be integrated into investment decisions in a variety of ways. Some strategies relate to increasingly important business and societal issues – others are more about reflecting investors' personal (or organisational) values or beliefs.

Given the growing importance of SRI issues – and its inclusion in the best practice Adviser ISO – taking SRI aims into account ought to form part of the investment decision process for all clients who have an interest in this area.

This guide will help address these issues and will help improve your knowledge and understanding of SRI and how to integrate it into your advice process. In addition, we believe that you will be better able to discuss this area more regularly with your clients and be better equipped to meet the growing demand that clearly exists.

The list of SRI Rated Funds and fact sheets that accompany this guide provide advisers with a choice of funds that have met our fund methodology within their identified sriServices 'Styles'. We are confident these provide a useful starting point for exploring this dynamic market and that the SRI Styles system helps you to shortlist relevant funds more effectively and efficiently than before.

Additional information and reading sources are also listed in the Appendix.

We hope you find this guide useful and we welcome any feedback to help us to make improvements for future editions.

Stewart Smith
Rayner Spencer Mills Research
www.rsmgroup.co.uk

Julia Dreblow
sriServices
www.sriServices.co.uk

April 2014

CONTINUED PROFESSIONAL DEVELOPMENT CPD

Appendix – About the Authors

Rayner Spencer Mills Research

www.rsmgroup.co.uk

Experienced, professional and trusted; Rayner Spencer Mills Research is an independent company established in 2004.

After many years working in the financial services market, we felt that the rapidly changing environment presented a unique opportunity to set up our own company to deliver quality independent research and ratings. Our work, whether for advisers or providers is made with total impartiality and without any conflict of interest.

Working across the whole financial services marketplace we deliver specialist research, analysis and support to a diverse range of financial advisers and planners helping them to ensure they deliver sound advice to their clients backed by rigorous and structured research and due diligence. In addition, our fund ratings are now recognised as the 'badge of quality' when selecting funds.

We also work with all the leading providers across the financial services sector offering our straight forward and pragmatic advice to help fund groups, life and pension companies and platform operators add value to improve their business performance and efficiency.

We understand financial services and we will work alongside you to deliver tailored solutions that are right for your business and your clients.

Stewart Smith – BA (Hons) Financial Services

Having graduated from Sheffield Hallam University with a degree in Financial Services, Stewart joined Bates Investment Services in 2000 and became part of the internal research team responsible for fund and product research, including construction of the recommended fund and product list for the company's financial advisers. This involved face-to-face meetings with fund managers plus attendance at investment conferences.

As part of our investment research team Stewart plays a key role in the ongoing review of our Rated Fund Service together with the provision of bespoke services to our adviser clients.

sriServices

www.sriServices.co.uk

sriServices offers specialist SRI and ethical investment support for financial advisers and those working in retail financial services. Activity is spread across three main areas:

- SRI information and training
- Online database and fact finding tools ('Fund EcoMarket' and 'SRI StyleFinder')
- Consultancy and collaboration

sriServices is an independent company run by Julia Dreblow (BA Hons, DipPFS). Julia was formerly the SRI Marketing Manager at Friends Provident – having started her career as a broker consultant with NPI in 1989. Julia was also an UKSIF board director from 2002 – 09 where she chaired their Retail Sub-Committee and helped set up National Ethical Investment Week.

Appendix – Research Methodology

The screening process is researched using fund analysis tools which we combine to evaluate the data. For quantitative screening we primarily use Financial Express for our data analysis combined with other external data checks and our own proprietary filtering system.

The qualitative part of the process combines a fund questionnaire, which is completed for every manager that we add to the recommended lists and contact with the groups and managers.

Our questionnaire covers all the main areas that we feel requires detailed documentation with any additional information sourced from the management groups. In addition to what is identified further below some of the other areas we collect data on are:

- Fund technical data –objective, sector and asset allocation, charges etc
- Range of investable assets
- Team structures and CVs
- Manager incentives
- Macro and Micro influences
- Decision making processes
- Buy and sell disciplines
- Company visits
- Turnover
- Attribution analysis
- Risk monitoring
- Fund Style
- Fund differentiators
- Research tools

The quantitative screening comprises the following measures:

Quantitative Screening

In all the following areas, funds are compared against set benchmarks and their peer group.

Performance

Fund performance is a good indicator of the ability of the fund manager, particularly if you look over a range of different market conditions. By assessing performance on a discrete yearly and rolling three year basis, we gain a good understanding of how the fund has performed, and therefore the strength of the fund management team in different investment conditions.

The discrete period analysis provides us with an opportunity to isolate performance and investigate performance anomalies. It also allows us to understand how the fund is likely to perform under certain market conditions which is important when combining funds for portfolios. We are now also able to identify manager performance across different roles as well as in the current position which helps us improve our longer term overview.

We measure performance over the most recent three years on both a discrete basis and a cumulative basis. Longer term performance is relevant if we can identify that the current manager/team is responsible otherwise we focus on the more recent data as we believe this is more appropriate. Performance is compared against the average for the sector, with funds that do not perform ahead of the average in at least two of the various data points being eliminated from the lists, subject to the qualitative overlay. Further filtering takes place when we mix in the qualitative information.

Volatility

Volatility is one of a number of statistical measures that we look at to further understand the funds and how they operate. We consider the funds in relation to their benchmark and sector and also in relation to their objectives.

Specifically we consider Sharpe ratios, information ratios, value at risk and maximum loss and measure each fund against its peers in order to find the funds performing in line with expectations.

Volatility measures are used in particular to assess risk in terms of relative positioning as well as in absolute terms. This allows us to judge the extremes of positions that fund may take which is important in building a balanced list of funds as well as when combining them in portfolios.

Again, we compare the funds against the average for the sector, but we also consider these measures in the context of the fund's investment aims and objectives. This may mean that funds that fail these measures may still be used if we feel this is understandable given the focus of the fund.

TER

The charges taken by the fund manager can impact substantially on the fund returns, particularly in flatter markets. We use the total expense ratio as our preferred measurement of the charges and look for mainstream funds to have a TER of under 2%.

Fund Size

Fund size is considered, as we want to ensure that the funds we are suggesting have sufficient ‘buying power’. For example, in the Corporate Bond market, some companies will only offer their Corporate Bonds to the key fund managers.

The minimum fund size depends on the sector, for established funds in the mainstream sectors (Balanced Managed, Cautious Managed, Corporate Bond, UK Equity Income, Europe, UK All Companies, Global Equities) we would generally look for a minimum size of £50m, however this would be reduced to £30m for sector funds (Specialist, Asia ex Japan, Japan, Global Emerging Markets, North America). We are not restricted by this policy and will consider funds (new launches for example) that fail this criteria if they fulfil a majority of other requirements.

Conversely, a fund can become too big, and too cumbersome to deliver strong returns against its initial objective, this is also something we would consider when recommending a fund.

Qualitative Screening

The qualitative screen allows us to look in more detail at the how the fund actually operates.

Fund Manager Background

We need to ensure that the fund management has sufficient expertise in the area in which it is operating. This involves making a judgement on the relevant experience of the team and also the roles and responsibilities within the team. It is also important to understand these roles and responsibilities so that, if a fund manager leaves, we can make a reasonable assessment of how this will affect the fund management by knowing who will take over and their relevant experience.

Fund Philosophy

This helps us to place the fund relative to their peers in terms of how the fund is managed in broad terms and what scope the managers have to deviate from the principles set. For example a fund may have a more flexible philosophy complementing a relatively strict process and we would need to understand which would have greater control in extreme market conditions. It also helps us to understand the general stance of the group as well as the individual funds characteristics.

Fund management processes

Much of the qualitative research is around how the fund operates, and how robust the fund management process is. This involves gaining a full understanding of how the fund is managed, what would trigger the manager to buy or sell a particular stock, what they are looking for in the stocks that they hold etc. We also look at how they monitor the fund holdings on an ongoing basis and how decisions on the fund are made.

Risk Controls

The risk controls that are in place are also considered. It is essential that risk is managed according to a robust process and in line with any published risk tolerances.

Manager Resources

The resources that the fund manager has available to them can be important in the success of the fund. We therefore look at what research capabilities there are within the fund management team (clearly important in finding new investment opportunities) and also at whether or not any research is bought in (this can be good as it can provide an alternative view, however in some cases it can indicate a lack of resource within the team). We also look at the fund managers other responsibilities. For example if the fund manager has to input heavily into other funds, then this can mean a lack of focus on the core fund, which may also affect future performance.

Monitoring Process

Selecting the funds is of course only part of the process – the ongoing monitoring of the holdings and the procedure for making changes is equally important in determining potential returns. We therefore consider the process used in monitoring existing holdings – what would trigger a review of a stock, or a sell, and how are such decisions reached.

Appendix – Appendix – Other sources of SRI Information

rsmrgroup.co.uk

Access to a list of pre-researched funds plus detailed fund and sector factsheets, for use by financial advisers.

sriServices.co.uk

A comprehensive, independent SRI and ethical investment training and support hub for financial advisers – including a range of explanations, ideas, tools and links.

FundEcoMarket.co.uk

A free SRI database tool for financial advisers from sriServices. It lists over 400 regulated Life, Pension, UT/OEIC and IT retail SRI options segmented by SRI style, asset type and product type. Its purpose is to help advisers shortlist relevant SRI funds from across the market. The database links to the StyleFinder fact find questionnaire via a drop down box.

sriStyleFinder client microsite (stylefinder.fundecomarket.co.uk/)

This microsite offers clients the option to identify their preferred 'SRI Styles' by completing an online supplementary SRI fact find questionnaire in their own time. The site carries brief explanations of the main SRI Styles and the same fact find questionnaire which is embedded within the Fund EcoMarket adviser tool.

YourEthicalMoney.com

This is a free consumer facing fund selection tool from research provider EIRIS , which lists the SRI and ethical issues that are considered by green and ethical funds.

EthicalScreening.co.uk

This is a free online database and directory of ethical funds which allows advisers to search funds according to ethical criteria. Register to use the database.

CapitaFinancialSoftware.co.uk

Access to a list of pre-researched funds plus detailed fund and sector factsheets, for use by financial advisers.

Additional Reading

The Guardian Financial Intelligence series includes a book "Green Money – How to save and invest ethically" – written by journalist and broadcaster Sarah Pennells, published June 2009

'Sustainable Investing: The Art of Long Term Performance' offers expert in-depth analysis of the international SRI market. Edited by Nick Robins and Cary Krosinsky.

http://www.amazon.co.uk/Sustainable-Investing-long-Term-Performance/dp/1844075486

Blue and Green Tomorrow adviser Bootcamp guide 2013 – http://blueandgreentomorrow.com/wp-content/uploads/2014/01/BGT-Guide-to-bootcamp-10MB.pdf

FT Adviser SRI Guide: http://www.ftadviser.com/2013/03/21/training/adviser-guides/guide-to-sustainable-and-responsible-investing-Gd9yx20wxgX6dH2oJyqmJN/article.html

You Tube introduction to SRI & ethical investment: http://youtu.be/V06yxLfOSRc (from sriServices)

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