Ready to play ball?

The last quarter of 2014 saw a wealth of activity in the sustainable and responsible investment world. Julia Dreblow highlights some of the recent shifts and considers what this may mean for advisers

One of the most common questions I am asked is: "How do you define SRI?". I generally respond by saying that any investment that considers social, ethical and environmental issues to a significant extent - alongside financial issues - can fall under this umbrella, adding that 'faith', particularly for advisers who are considering ISO22222 or BS8577 accreditation, is an important fourth criterion.

For all intents and purposes, until a few years ago this had tended to mean ethically screened or themed funds plus options with some form of 'responsible investment overlay'. But over recent years there has been much activity between these extremes - and in some areas the lines are increasingly blurred.

Europe-wide SRI growth

Gathering statistics on this area is the role of Eurosif, the European Sustainable Investment Forum. As well as acting as a liaison with the European Commission for the SRI community, Eurosif produce an excellent biennial country-by-country SRI study. The report focuses on showing total assets (to the end of the previous calendar year) and percentage growth since the previous report (two years prior).

Figure 1 shows how SRI has, in many respects, gone mainstream with total European assets now approaching €17 trillion. The most notable example of recent expansion is 'exclusion based strategies', which now account for about 41% (€7 trillion) of all professionally managed European assets. But before you get worried, these are not exclusions as we know them in the UK retail ethical fund market. This is largely made up of major investors selecting one or two areas to avoid - such as cluster munitions and anti-personnel landmines.

For a range of reasons the Eurosif segmentation of the European SRI market is not identical to the 'UK only' sriServices and Fund EcoMarket classifications. However, the two are comparable in many respects. Indeed, their report confirmed the UK as the largest SRI market in Europe, noting high levels of innovation and a diversity of approaches.

UK growth

In terms of assets, the biggest area of UK SRI is what Eurosif calls 'Engagement and Voting', which means regular funds that aim to influence companies through active, responsible share ownership. Although under-promoted to advisers, total UK assets covered by this strategy now exceed £1.43 trillion, having grown by 31.8% between 2011 and 2013, partly as a result of the FRC Stewardship Code.

At the other end of the spectrum is the newer area of 'Impact Investment' (or 'Social Investment'), which focuses on measuring social outcomes alongside financial goals. Indeed, thanks to Government support in the form of setting up 'Big Society Capital' and the new Social Investment Tax Relief (SITR), this area looks set to compete with VCTs and EISs for the affections of the ultra high net worth. The www.ImpactInvestor.co.uk is a good source of information on this area. The only 'regular' fund in this area is the relatively new Threadneedle Social Bond - a standard corporate bond fund that will only hold investments where positive social benefits are clear. This includes areas such as social care, education, health and local authority bonds.

Yet on a day-to-day basis, the middle ground of SRI generally commands the most attention among UK financial advisers. This includes funds that are commonly referred to as 'sustainability', 'environmental', 'SRI themed' or 'ethical'. Such funds do often aim to encourage or support positive progress but their focus is generally 'big business', not smaller individual enterprises. Those with a deeper sustainability remit, such as the WHEB and Alliance Trust funds, are typically more focused on effecting change through investment - whereas the more 'ethically focused' options, such as those from Ecclesiastical, Rathbones, F&C and Kames, are typically focused on selecting more responsible, larger companies.

Good Money Week

This area is a major focus of what is now called 'Good Money Week' (formerly National Ethical Investment Week). The UKSIF organised 'week', held in mid-October, saw much activity this year, with fund manager Alliance Trust leading the charge by running 28 adviser events.

The centrepiece of the week, however, was a reception at the House of Commons, where a 'hustings' style MP debate took place. Speakers referenced the UK's leadership in climate change in 2008 when the UK passed the first ever Climate Change Act (there are now 500 other pieces of climate legislation in 66 other countries). This was, however, contrasted with areas of concern, such as George Osborne's unwillingness to discuss 'decarbonising' with major pension funds.

Unburnable carbon

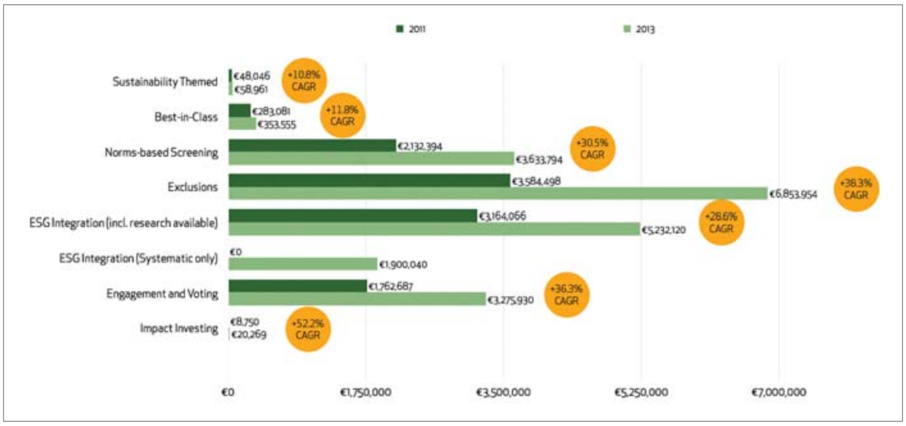
This criticism was in stark contrast to the excitement around the speech made a week earlier by Mark Carney, Governor of the Bank of England, with regard to 'Big Oil'. Carney is reported to have told a World Bank seminar on integrated reporting that the "vast majority of [oil] reserves are unburnable" if global temperature rises are to be limited to below 2°C.

His remarks relate to research that says 80% of fossil fuel reserves will be "unburnable" if world temperature rises are not to exceed the agreed 2°C increase.

The implications for almost all investors are significant. $5 trillion of oil and gas company assets risk being potentially 'stranded', which is why references to the existence of a 'carbon bubble' are increasingly common.

Unsurprisingly perhaps, there are calls for this to be brought into sharper focus. Indeed, at a recent All Party Parliamentary Climate Change Group (APPCCG) meeting, the following four sentiments stood out clearly:

Figure 1: Overview of SRI strategies in Europe (Eurosif: 2014, in Millions of Euros)



- **Government & leadership**. Calls for better leadership were frequent. One speaker articulated the mood by remarking that: "The role of Government is to protect the long term wellbeing of the people they represent, not to ensure that everyone can always have all the cheap energy they want." There were also many references to China's growing interest in this area. The fact that it is harder for democracies to act on issues of this magnitude did not elude the audience, but using democratic processes as a reason for short-termism and inaction were clearly not considered acceptable either! In essence, the view of the APPCCG was clear in this regard - the UK and Europe need to act fast to maximise business benefits and reduce all-round risk.

- **17 years.** At the current 'rate of burn' we are likely reach +2°C average temperature increases by around 2031, according to reports. A 'catastrophic' 3-4% increase would, according to the speakers, be likely to follow only a few years later. This +2°C maximum increase (and the corresponding 350ppm atmospheric carbon ceiling) referred to as the 'Global Budget' have been widely accepted internationally and are no longer open to serious debate. But less regularly discussed is the fact that a 17-year target is achievable - if we get a move on. In terms of investment these are sensible timeframes, but the investment opportunity window is now.

- **Stranded assets risk**. Mark Carney's recent comments about the majority of fossil fuel reserves being "unburnable" was widely discussed and welcomed. Yet, the non existent response of the investment markets surprised even SRI old hands. Fear of a sudden correction in investment markets (and analysis of possible knock-on effects) is therefore growing.

- **The cost of 'Big Oil'**. The cost of fossil fuel extraction is rising as reserves become harder to exploit - think tar sands, ever deeper water drilling, arctic exploration and geopolitical risk. Indeed, some projects require oil to be at $200 a barrel to be viable, rather higher than today's $50. Conversely, the cost of renewable energy is falling fast. As such, irrespective of climate issues, this industry faces many challenges, whereas the case for renewables is improving all the time. Continued investor support for oil companies was therefore described as costly and bad for all businesses - although commentators observed that like the tobacco industry of yesteryear oil companies' 'fight-back' should surprise no one.

Play ball or play chicken

So where does all this leave advisers? Like it or not the investment tanker is starting to turn. Eurosif figures indicate that retail investors are being horribly left behind at present, but this does not alter the overall scene.

So as approaches like 'overlays' and 'ESG integration' (environmental, social and governance) grow and specialist products flourish, advisers effectively have a choice: play ball or play chicken.

Some big names have 'played chicken' with public opinion in this area this year, such as the Church of England with their very unfortunate 'Wonga moment' and Comic Relief with the Panorama exposé of their investment in armaments, tobacco and alcohol companies. But in the main, investors are increasingly getting involved.

From Aviva, F&C and others' engagement and integration models and Vanguard's support of the (mainly Nordic) 'norms based' model through to sustainability themed and ethical options, investor choice is improving.

Whether or not next year's UN climate talks in Paris (COP21) will be a major turning point for investors remains to be seen. But for those advisers wondering whether or not to talk to clients about such issues, one simple question may be useful: "Do you think these issues are going to become more, or less, important over the next 10 to 20 years?".

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