Enquiring stewards... researching the issues others may fail to consider

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The last time I contributed to Connections, in late 2014, I talked about fears of a 'carbon bubble' and the Governor of the Bank of England's first public reference to the risk of 'stranded assets'.

Much has changed since then. In particular; COP21, the Paris climate change conference where 195 countries signed an agreement to limit temperature rises to below 2°C - and the divest campaign. Both look set to shape the way people think about energy and climate over the coming years.

The fact that that coal, oil and gas reserves cannot all be burned - if we are to avoid catastrophic climate change - poses significant questions for investors large and small, 'ethical' or 'otherwise'.

However fossil fuels are not the only high profile issues that investors may wish to consider.

Military action in Syria, heartbreaking images of refugees, tempers fraying over gay marriage within the Anglican Church, loss of biodiversity and a diesel fuelled corporate disaster – all are high profile issues people may want to reflect in their investment decision making.

Investment managers label such issues with rather unwelcoming terminology like 'avoidance of strategic armaments', 'human rights', 'equal opportunities', 'resource management' and 'corporate governance' ... but they are none the less relevant.

The industry is however moving towards better management of such issues. The FRC Stewardship Code, for example, encourages longer term thinking and greater engagement.

'Mainstream' fund management responses can be broadly split into two, albeit overlapping, groups; research intended to inform buy/sell decisions - and ongoing 'activity' with investee companies.

The former, 'ESG integration' (Environmental, Social and Governance), is increasingly used to improve risk management. It typically involves researching areas that would otherwise be overlooked – and voting shares accordingly. Activity with existing investee companies meanwhile can take many forms take many forms - variously referred to as 'responsible ownership, stewardship and/or engagement'. This involves investors thinking of themselves as 'stewards' or 'part owners' - and typically involves encouraging better management of material ESG issues through dialogue, voting and sometimes shareholder resolutions.

Alliance Trust, Jupiter, Pictet, Sarasin & Partners, BMO (F&C) and Aviva are good examples of investors who are active in these ways. The Sarasin 'House Report', for example, weaves easily between ESG and financial issues. Their work in this year's 'Aiming for A' shareholder coalition is likely to be high profile as they and others are asking AngloAmerican, Glencore and Rio Tinto to show that they are working to lessen the impact of climate change on their businesses - ahead of this year's AGM. This follows last year's program, led by CCLA, which resulted in 98% of shareholders backing a similar resolution at Shell and BP. So this will be one to watch.

In these changing times there can be no downside to understanding clients' aims better. Indeed you are likely to find that as stewards of your clients' financial plans this is an increasingly essential skill set.

This train of thought is taken even further by some funds of course.

Many chose to put 'sustainability' and other 'ethical' issues front of house. Approaches vary greatly with some focusing more on 'finding companies with winning longer term strategies - given the way the world is changing - while others focus more on finding attractive 'ethically appropriate' holdings.

To help advisers make sense of this diversity and match it to clients' aims we have come up with the 'SRI Styles' segmentation system – as used in Fund EcoMarket and by RSMR in their 'Rated SRI fund' service.

In brief - the recently reviewed segments are:

- **ESG Integration** - conventional funds that also research material 'Environmental, Social and Governance' risks.
- **Responsible Ownership & Engagement** - conventional funds that actively encourage better ESG management through 'responsible ownership' - for the benefit of investors.
- **Sustainability Themed** funds focus on companies' responses to sustainability issues to help identify investment opportunities. These regularly include ethical criteria also. See options from Alliance Trust SF range, Quilter Cheviot, Triodos, Impax and WHEB.
- **Environmental Themed** funds focus on environmental issues to help identify opportunities. These may include ethical criteria also. See options from Jupiter, Pictet and Scottish Widows.
- **Social Themed** funds focus on social (people) issues when selecting investments. May include ethical criteria. eg Columbia Threadneedle Social Bond.
- **Ethically Balanced** funds combine positive and negative ethical screening criteria. May use 'best in sector' strategies and allow diverse investment. See options from Rathbones, EdenTree, Henderson, Standard Life, BMO/F&C, Friends Life.
- **Negative Ethical** funds employ strict 'negative' values based 'ethical' criteria – which may mean they exclude a number of sectors. See options from Kames, Alliance Trust Ethical (ex NU) and OMW Ethical.
- **Faith Based** funds avoid companies in line with religious principles (eg Shariah Law). (Note: many ethical funds also have 'faith friendly' policies).

(The 'triangle' image shown illustrates a rough 'allowable universe' for investment).

This system is intended as a guide that helps highlight core strategies. Within each style strategies vary - and there are areas of crossover. Many 'Themed' options, for instance, list ethical avoidance criteria although these may have little impact on stock selection (as themes drive where they will invest).

In addition, things change. Only a short time ago the term 'fossil free' was almost unknown to investors, diesel was in favour and there was no Social Investment sector.

For advisers, the winning formula can only be to focus on what clients' want - by asking them.

Identifying priorities with the help of a supplementary fact find is an easy way to do this. Our online 'SRI StyleFinder' fact find is free to use and as a Synaptic user you will also have access to their updated 'issues based' questionnaire.

These methods are quite different, but both are supported by tools, links and reporting functions. In these changing times there can be no downside to understanding clients' aims better. Indeed you are likely to find that as stewards of your clients' financial plans this is an increasingly essential skill set.

Notes

i http://newsroom.unfccc.int/unfccc-newsroom/finale-cop21/
ii https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code.aspx
iii See Sarasin entry on www.FundEcoMarket.co.uk for report link