

For Professional Advisers only

Square Mile ESG Integration Q&A

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Introduction

We believe the consideration of ESG factors to be of growing importance in asset management. Successful approaches are increasingly being used to great advantage both to enhance returns and, perhaps more importantly, to understand and manage risk. Furthermore, the analysis and integration of ESG factors is of high importance to many investors.

The consideration of ESG factors is increasingly being incorporated into investment processes. We have developed an approach to analysing and articulating the various approaches to ESG integration which inform our research process. We hope this will help investors to better understand how their investments are managed.

What is ESG Integration?

The extent that environmental, social and governance criteria are integrated across the company's investment processes or within a specific fund.

Could you explain what Square Mile is seeking to achieve through ESG Integration?

Over recent years it has become clear that for many investors the power of good that their investment can have is equally important as its potential financial gain. ESG-aware investment has come from being a consideration for a marginal group of investors to a mainstream investment discipline. Similarly, we believe that an assessment of a company's and fund's ESG credentials should play a formal role in our overall research and due diligence, rather than as a segregated afterthought. By publishing the outcomes of our research on ESG Integration at the company and fund level, we are aiming to provide a complete picture of all relevant information relating to an asset management company and the funds it offers. Based on this information, an adviser can then make a fully informed decision over the suitability of a company or a fund within a client portfolio.

Why is Square Mile's ESG Integration of value to advisers and their clients?

Based on feedback from our clients, there is a strong demand for a clear metric that enables them to assess the ESG credentials of their investment partners, both at a fund and company level. ESG is increasingly forming a central role within asset managers' business models and we believe that a consideration of ESG factors should be an integral part of research into all funds and the companies that offer them. Advisers and their clients can then choose to refine their preferences over investment partners based on a fully informed view of any ESG philosophy at a fund or a company level.

Could you define what Square Mile means by ESG investing?

We recognise the universe of funds that embrace some form of ESG approach to security selection and portfolio management is very wide and that there is frequently a subjective nuance to the terminology asset managers apply. This has the potential of leading to some level of confusion for advisers and their clients alike. We look at ESG integration first at the company level, assessing what resources the company has in this area and how it applies them in terms of support to fund managers and also activities such as engagement and voting, as well as the company's commitment to furthering ESG integration across their business. At the fund level we look to see which factors managers incorporate, how they use them and how this may impact the risk and return of the fund.

How will a company's or fund's ESG Integration company or fund assessment be expressed?

To enable Square Mile to assist advisers and their clients in their journey we have sourced data from asset managers. We have obtained examples of their ESG policies in practice and integrated them with their companies' ambitions. Each company and fund within the Academy of Funds will be assessed and allocated an ESG Integration company or fund assessment from zero to three based on our evaluation of their approaches to ESG investment. These scores reflect our level of conviction on how integrated the approach is within the company and at the fund level. For instance a company may have a high ESG Integration relating to their approach but a lower fund assessment for their application of that at strategy level.



We also include, where possible, the UN PRI Strategy & Governance rating, one of the most widely recognised points of reference utilised in the market. We have asked for this information from asset managers and have included this information where they have given us access.

An example of how this looks in practice is as follows:

Company Assessment	0	1	2	3	Fund Assessment	0	1	2	3
ESG factors are fully integrated and are instrumental to the company's investment processes.					ESG factors may be considered by the fund's manager as an input into their analysis but are not a formal part of the investment process.				
UN PRI Strategy & Governance Rating					A				

Could you outline your process in assigning ESG Integration company and fund assessments?

We apply a qualitative assessment. Every company and fund is different, and we assess each on its own merits. We use primary data, sourced directly from the companies and managers using proprietary questionnaires and through face-to-face meetings seeking evidence to support the assessment. We then overlay this with our experience and expertise as analysts in order to cut through the terminology and to make sense of the facts.

At a company level (ESG Integration company assessments), we assess the policy, resources, monitoring and assessment of ESG factors, risk management, engagement and voting practices. We want to know to what extent these are applied consistently across the business seeking evidence of application and its investment processes, or left to individual teams and managers to determine their own approach.

At a fund level (ESG Integration fund assessments), we seek to understand if and how ESG factors are considered in the management of individual funds. We assess how ESG factors are used as an input into the process, which factors are considered, how they impact the research, portfolio construction and risk management processes. Based on this assessment, we grade each company and fund on a scale of zero to three with our definitions listed below. These scores are not necessarily linear.

ESG Integration Company Assessments:

0	The company does not have an explicit, or discernible approach to, the consideration of ESG factors.
0+	The company has begun work to identify the methodology to be used for introducing ESG factors.
1	The company has some, but limited, consideration of ESG factors across some of its investment teams but these are not a formal part of its investment process.
1+	The company has made ESG factors available to the investment teams as an input to their analysis, but they are not compelled to consider that as a factor when making investment decisions.
2	ESG factors are considered formally but are not instrumental within all of the company's investment processes.
2+	Demonstrable steps are being taken to fully integrate ESG factors into all of the company's investment processes.
3	ESG factors are fully integrated and are instrumental to the company's investment processes.



ESG Integration Fund Assessments:

0	There is no discernible approach to, or consideration of ESG factors in the fund's investment process.
0+	The fund manager has begun to evaluate how they may incorporate ESG into their investment process.
1	ESG factors may be considered by the fund's manager as an input into their analysis but are not a formal part of the investment process.
1+	ESG factors are available to the fund managers as an input to their analysis, but they are not compelled to consider them as a factor when making investment decisions.
2	ESG factors are actively considered by the fund's manager as an important part of the investment process , but do not drive the final investment decision.
2+	The manager is taking demonstrable steps to fully integrate ESG into the management of the strategy.
3	ESG factors are fully integrated and are instrumental to the management of this strategy.

Why should ESG Integration matter to investors who are not concerned about the societal impact of their investments?

There is always likely to be a number of investors for whom ESG investing is not important. The application of ESG at its most broad level can be seen to help manage the risk of a business or a particular portfolio. The 'E' (Environmental) is assessing the impact a business has on its surroundings, the 'S' (Social) is how a company/ its employees operate in our society and the 'G' (Governance) is the importance of good corporate governance. We believe that these considerations have grown in importance significantly in helping mitigate against risks.

Is it fair to assess a company for its ESG Integration when this does not form part of its corporate philosophy?

We believe the value of successful ESG integration will grow in importance and lead to better investment decisions. However, we realise that this information is increasingly important to advisers and their clients and therefore believe that it should play an important role in the research that we carry out. We believe that we will create considerable value in expressing our conclusions in a clear and transparent way that is easy for advisers to understand. They can then decide with their clients how they weight this information when making investment decisions.

Does it matter that an ESG fund is offered by an asset management business that has a low-scoring ESG Integration company assessment and vice versa?

This is not for us to answer, but rather the individual investor must decide this. Our assessment is looking to provide guidance to enable advisers to make their own informed choices when building solutions to meet the specific requirements, ESG or otherwise, of their clients. We recognise the importance of this approach and acknowledge that different providers and funds will be suitable for different clients.

Will all funds within the Academy of Funds that are assigned a good ESG Integration assessment also receive a Responsible rating?

No. ESG Integration and Responsible ratings are different things, and our analysts assess them as such. It is likely that many funds with Responsible ratings will have high ESG scores, and vice versa, but this is by no means a given. The two processes are separate and look for different criteria. For a full description of each process please see the two methodology documents.

Are you not doubling up and potentially introducing more confusion by introducing Responsible ratings and ESG Integration fund assessments?

ESG Integration is an expression of how Square Mile acknowledges the importance of referencing ESG considerations as an integral part of our overall investment research in building up a comprehensive view of a company and its funds. Responsible ratings will be reserved for those funds which in our opinion are best-in-class in its area and reflect a combined judgement on a manager's ability to meet their objectives in financial terms as well as an adherence to the exclusion, sustainable or impact approach they take to security selection and portfolio management. These two initiatives are complementary in that they formalise our approach to ESG and responsible investing across our research but have distinct objectives.

Will ESG Integration company and fund assessments only be applied to funds and companies represented within the Academy of Funds?

Yes, although this is not a static group. We continually review funds and companies for their potential to be added to the Academy of Funds.



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