

3D Investing Methodology

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Introduction

Responsible Investment (RI) has become a powerful force within our industry in recent years.

Pressing environmental and societal challenges are now seen by both governments and investors alike, who are looking beyond traditional financial metrics and instead are harnessing the power of money to create a positive impact on the world. Effective responsible investing is able to support a healthier planet, a more equitable society, and ultimately a more sustainable future.

At Square Mile, we aim to help investors navigate the changing RI landscape and make meaningful and informed decisions.

New regulations are being introduced. In November 2023, the United Kingdom's Financial Conduct Authority (FCA) published the Sustainability Disclosure Requirements (SDR) policy statement which aims to improve transparency of sustainable investment products for retail and professional investors.

SDR Labels

Sustainability Impact: Self-labelled funds that seek to achieve specific pre-defined, positive, measurable environmental and/or social impact.

Sustainability Focus: Self-labelled funds that seek to invest in assets that are environmentally and/or socially sustainable evidenced by a robust, evidence-based standard of sustainability.

Sustainability Improver: Self-labelled funds that seek to invest in assets with potential to become more sustainable over time, determined by a robust and evidence-based standard of sustainability.

Sustainability Mixed Goals: Self-labelled funds that seek to invest across different sustainability objectives and strategies.

Source: FCA: Policy Statement PS23/16: Sustainability Disclosure Requirements (SDR) and investment labels.

The 3D Framework:

At Square Mile, we use our proprietary 3D framework for assessing responsible funds. We see RI as an umbrella term which is underpinned by the 3D pillars of "Do Good", "Avoid Harm" and "Lead Change". We believe that our framework will support investors and advisors in making informed investment decisions by providing a useful representation of how a fund fares from a RI perspective.

3D Pillars

Do Good

Investment in companies offering solutions to global social and environmental challenges and evidence of impact.

Avoid Harm

Avoidance of investment in companies making a significant negative contribution to society and the environment and those exposed to controversies.

Lead Change

Advocacy and engagement with investee companies both individually and through co-operation with other investors and change activists to encourage best practice and inform opinion. Strong research processes, company culture, and stewardship, at a company level.

The 3D process is comprised of data collection from the fund's manager, data processing, revenue-sources analysis, assessment of alignment with environmental and/or social matters, and qualitative opinion. Once a fund's portfolio has been run through the framework, each fund will achieve a 3D Rating and an associated medal.

We are cognisant that not every sustainable fund has the same objective. Strategies that target investments in companies that offer solutions to environmental challenges have a contrasting objective to a strategy that invests in companies that are improving their sustainability credentials through active engagement. Therefore, 3D has created four unique scoring frameworks utilising the three pillars of do good, avoid harm, and lead change. The four scoring frameworks apply to four broad fund categories of Impact, Focus, Improvers and Mixed Goals.

As part of this process, once we have collected all the necessary information on a fund's portfolio composition and its strategy, we will run the fund through the 3D framework that aligns with the stated sustainability objective of the strategy, which is more thoroughly outlined in Step 6 of the methodology.

Step 1: Identify Funds

Using the 3D Framework, we will assess funds across all four of the RI approaches that we have identified.

Typically, we would expect funds to have a sustainability objective reflected in their mandate and a clearly articulated philosophy and process that identifies what the fund is trying to achieve from an RI perspective and why. For example, an impact fund manager's theory of change or how an improver fund manager is evidencing improved company sustainability credentials.

However, while sustainable funds are best suited for a 3D rating, the 3D framework will also be able to assess traditional funds with no clear responsible mandate. We are able to assess the sustainability credentials of traditional funds, but they will only be eligible for a 'Reviewed' award.

Step 2: Obtain fund portfolio information and supporting documentation.

The 3D sustainability profiles are based on evidence, with all funds undergoing a detailed examination of their holdings in order to identify controversies and the extent of the exposure to social and environmental solutions.

Portfolio

The current fund holdings and portfolio weights are obtained from the fund manager.

Questionnaires

In addition to the portfolio holdings, a detailed questionnaire is required to be completed by the fund manager and fund group.

The fund-level questionnaire considers:

- **SDR Label (where applicable):** This is the label that the fund manager has self assigned to.
- **Approach:** Identifies, if any, which types of RI approach is adopted by the fund.
- **Exclusions:** Any exclusion criteria employed by the fund.
- **ESG:** Approach to ESG integration at the fund level.
- **Engagement:** Data on success of engagements and percentage in E, S and G.
- **Voting:** Considers the extent to which the fund manager exercises votes in companies and importance of E and S in voting.
- **Impact Footprint (where applicable):** Extent of measurable impact of the fund, e.g. waste intensity vs. benchmark, water intensity vs. benchmark, carbon intensity vs. benchmark, etc.
- **Impact outputs (where applicable):** Megawatts of clean energy generated by the fund, metric tonnes of carbon avoided, number of people receiving health treatment, amount invested in affordable housing, etc.

The fund-group questionnaire considers:

- **Research Process:** Refers to the policies and procedures, systems and tools within the business that support portfolio managers in carrying out their day-to-day roles. This considers the team's ability to deliver strategy, number of RI staff, ESG databases, data subscriptions, RI committees and memberships.
- **Company Culture:** Refers to the business entity and not the assets it manages.
- **Advocacy & Stewardship:** Refers to advocacy and engagement with investee companies both individually and through collaboration with other investors and change activists to encourage best practices and inform opinion. It will consider the degree of collaboration with other shareholders, educational initiatives and thought leadership as well as membership of institutions (e.g. UN PRI). Additionally, it considers assets held within the various investment funds and strategies and not the business.

Supporting documents

The fund manager is also asked to provide any supporting documents which provide further evidence and insight into the fund's and company's process. This will potentially include UN PRI reports, stewardship reports, Responsible Investment reports, impact reports, engagement reports, fund & group presentations, process documents, ethical criteria statements, marketing documents in respect to ESG integration and any other insights that the fund manager is willing to share.

Step 3: Determine Fund Type

Contained within Step 2 is a field that allows the fund's team to state their official SDR label. If stated, we will assess the fund within the 3D framework using that label and the fund will be rated against the 3D scoring framework for that specific label. In instances where a fund manager is hesitant to self assign a label, the 3D team will conduct a preliminary assessment that considers a fund's sustainable objective, its formal documentation (e.g., RFP), and expected outcome when run through the 3D process. On completion of this preliminary assessment, we will consult with the fund manager and state our proposed scoring framework. If the decision made within this preliminary assessment differs from the fund's manager, we will request formal evidence as to why an alternative scoring framework should be used for our analysis.

Step 4: Match portfolio against 3D Investing Atlas database

Do Good: 3D Themes

Every holding in the portfolio is cross-referenced against our proprietary Atlas database. In its simplest form, the Atlas database has mapped a dataset of c.10,000 company activities into c.390 distinct 3D revenue activities. This functionality allows 3D to map an entire portfolio's aggregated revenue to one of these 3D revenue activities. For example, as of December 2023, General Electric, the American multinational conglomerate, had its revenue split into the following activities: Aerospace Manufacturing (39%), Electric Generation Support (21%), Industrial Manufacturing (21%), Alternative Energy - Wind Power (6%), General Military (3%), Smart Grid Technologies (3%), Insurance (2%), Alternative Energy - General (2%), Alternative Energy - Hydro (2%), Software - General (1%). When aggregated across an entire portfolio, Atlas is able to identify discrete timestamped activities at a very granular level. When the portfolio's analysis-eligible portion has been mapped via Atlas, each entity is broken down into underlying activities that are relevant to the time of the investment.

Utilising Atlas, the 3D team is then able to identify a sustainability profile of the portfolio. To this end, Atlas measures four important sustainability metrics: solution alignment, sustainability characteristics, controversial activity and harmful impact exposure.

Firstly, each of the c.390 revenue activities has been mapped to one of the 3D Investing classifications outlined below. These categories have been designed to help align a portfolio's composition to a specific sustainability theme.

	Circular Economy: Waste management and recycling, environmental consultancy, etc.		Renewable Energy: Solar, wind, hydro, etc.
	Education & Training: Educational publishing, education establishments, training, etc.		Resource Efficiency: Energy efficiency, natural resource efficiency, waste management and recycling, etc.
	Healthcare: Medical equipment, pharmaceuticals, healthcare services, etc.		Safety & Security: Cyber security, building and automotive safety, food safety, etc.
	Inclusive & Ethical Finance: Microfinance, sustainable investing, peer to peer lending, etc.		Social Infrastructure: Social housing, emerging markets telecommunications, hospitals, etc.
	Low Carbon Transport: Train & tram operators, bus & coach operators, bicycle manufacturers, electric vehicle manufacturers, etc.		Sustainable Food: Food storage, reduction in non-renewable inputs for farming, renewable farming alternatives, high welfare food manufacturers, etc.
	Natural Capital: Water supply & sanitation, water filtration, air filtration, forests, etc.		

If a revenue activity is not able to be assigned to one of the above 3D categories, it will fall within one of the below categories:

- **Limited Positive Solutions:** Product and/or service neither presents a solution to social and/or environmental challenges nor delivers a major level of harmful impact.
- **Harmful Impact:** Product and/or service delivers/contributes a major harmful impact to society and/or the environment.
- **Transition Enabler:** Product and/or service which does not tackle an environmental or social challenge immediately and may often result in direct negative environmental or social impacts but is a potential requirement in the transition to a sustainable future.

Do Good: Revenue Activity Framework (RAF) Characteristics

In conjunction to thematic classifications, the 3D framework is able to attribute specific sustainability characteristics to each revenue activity, a process labelled RAF. Each activity is assigned with one or more RAF characteristics, such as impact or sustainable, which is directly linked to the sustainability benefit of that activity. Additionally, each RAF characteristic is attributed to either the environment or society, based on its positive benefit.

Each revenue activity allocated to a RAF characteristic has the potential to be assigned more than one characteristic in order to appreciate multiple outcomes. For example, for the revenue activity ‘Alternative Energy—Solar’, we have assigned the environmental impact characteristic to the known material positive impact on the environment through decarbonisation. However, we have also assigned this activity a secondary social sustainable characteristic on the basis that, alongside helping to decarbonise our energy systems, solar projects also help to improve global energy security, thus helping to reduce energy poverty and boost local wealth and employment prospects. Both characteristics are measured to establish a full spectrum of influence.

The definitions of what is considered Impact or Sustainable is shown below, but full revenue activity RAF characterisations are available within the fuller 3D methodology, which is available on request.

- **Impact:** shows clear and direct intent to tackle environmental or social challenges.
- **Sustainable:** an activity which offers some social and/or environmental benefit but is not necessarily its core focus.






















If a revenue activity is not attributed one or more RAF characteristics, it will be automatically characterised as a Limited Positive Solution, Transition Enabler, or Harmful Impact, as per its 3D classification.

Avoid Harm

The next stage of the 3D Investing analysis involves identifying a portfolio’s exposure to activities deemed controversial under the 3D framework.

Controversial activity flags are assigned to activities deemed to be of high risk of negative environmental and/or social impacts under the 3D framework. These activities will often reside within questionable industries, such as those surrounding gambling, tobacco, and adult entertainment. Additionally, controversial activity flags may also be attributed to revenue activities that are typically at high risk of being exposed to a contentious topic; for example, textile manufacturing may be exposed to high water usage that negatively affects the operations surrounding environment.

Of the c.390 revenue activities, c.37% have been assigned a controversial activity flag. Full controversial activity flags and their justifications are available within the fuller 3D methodology, which is available on request.

Controversial Activity Exposure						
						
Adult Entertainment	Alcohol	Animal Testing - Healthcare*	Animal Testing - Personal Care	Animal Welfare	Cannabis	Ecological Degradation
						
Energy Intensity	Fossil Fuels	Gambling	GMOs	Hazardous Chemicals	High Carbon	High Sugar
						
Human Rights & For Profit Prisons	Military Weapons	Mining	Nuclear	Predatory Finance	Tobacco	Water Intensity

Step 5: Questionnaire Scoring

The Lead Change part of our analysis incorporates a qualitative process that relies on questionnaires, desk reviews, and in-person meetings with the fund group.

As previously outlined in Step 2, each fund run through the 3D process will require two questionnaires to be completed, which are detailed below.

By assessing both questionnaires, we will be able to measure how effective a fund and a fund group are at Leading Change across the RI sector.

1) Company ESG

At the company level, we seek to understand if and how an asset manager integrates the consideration of ESG factors into its investment processes. 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 and its investment processes, or left to individual teams and managers to determine their own approach.

This is a qualitative assessment. Every company is different, and we assess each on its own merits. We use primary data, sourcing it directly from the companies and managers involved, and seek evidence to support the assessment. We then overlay this with our experience and expertise as analysts which allows us to assess and challenge the information provided.

The Square Mile Company ESG Questionnaire is made up of 34 questions that enable us to understand a fund group's research processes, company culture, and stewardship. We believe these factors are pivotal in their ability to lead change internally and externally.

2) Fund Stewardship

Fund Stewardship refers to advocacy and engagement with investee companies at a fund level. Each fund that is run through the 3D process will have to complete an extensive questionnaire that will provide the analyst with information on the fund's RI approach, its exclusionary criteria, ESG framework, engagement process, and voting practices. Utilising the information provided, the 3D analyst will score the fund on 10 questions that enable us to understand the fund's RI and stewardship credentials.

Step 6: The Ratings Framework

Once all necessary information has been collated, the fund is ready to be assessed. As previously outlined, the 3D framework is able to assess funds based on their primary sustainability objective. We would anticipate that a self-labelled SDR Improver Fund, for instance, will be more heavily weighted towards the fund's ability to Lead Change through effective stewardship, whereas an Impact Fund will be more heavily weighted towards its ability to Do Good and invest in impactful activities.

If a fund has an official SDR label, this will be used to determine which rating framework the fund will be assessed against. For a fund without an official SDR label, 3D will assign the relevant classification based on an assessment that considers a fund's sustainable objective, its formal documentation (e.g., RFP), and expected outcome when ran through the 3D process.

The table below provides a rough outline on what each of the four 3D frameworks considers when scoring a fund. A Sustainability Impact fund, for instance, is more heavily weighted towards Doing Good, owing to its objective of investing in higher impact companies. Contrastingly, a Sustainability Improver fund is more heavily weighted towards Leading Change, owing to its objective of investing in companies whose products and/or services improve in its sustainability credentials over time.

Fund Type	Do Good	Avoid Harm	Lead Change
Sustainability Mixed Goals	Medium	Medium	Medium
Sustainability Improver	Low	Low	High
Sustainability Focus	Medium/High	Medium/High	Low
Sustainability Impact	High	Low	Low

A more detailed description of our ratings framework for each sustainability objective is below.

Sustainability Mixed Goals

Do Good: Sustainability Mixed Goals strategies will typically aim to Do Good by investing in companies whose products and/or services either have a direct intent to solve environmental and/or social challenges, possess relatively strong impact and/or sustainable characteristics than traditional funds, or by investing in companies that do not possess clear sustainability characteristics, but whose credentials are expected to improve over time. Do Good is weighted equally to Avoid Harm and Lead Change.

Avoid Harm: Sustainability Mixed Goals strategies will typically possess a balanced objective of investing in solutions and/or sustainable products and/or services, but they will also allow for investments in harmful and controversial activities if the governing team/group intends to engage on improving this exposure to these activities. Avoid Harm is weighted equally to Do Good and Lead Change.

Lead Change: Sustainability Mixed Goals strategies will focus on engaging with investee companies on their exposure to harmful impact activities, controversial activities, and overall ESG credentials. We believe that all groups should aspire to have strong and effective internal research processes, company culture credentials, and stewardship capabilities. At a fund level, the team can evidence how it is driving positive change through the fund stewardship questionnaire and the provision of supporting documentation. Lead Change is weighted equally to Do Good and Avoid Harm.

Sustainability Improvers

Do Good: Sustainability Improvers funds will typically Do Good by investing in companies that do not possess clear sustainability characteristics but whose credentials are expected to improve over time. Therefore, it is often the intention to not invest in solution-based companies. Do Good is weighted minimally within the Sustainability Improvers category.

Avoid Harm: Sustainability Improvers strategies typically have a greater exposure to companies that provide products and/or services that negatively impact the environment and/or society and those that derive their revenue from activities that are exposed to activities deemed controversial in the eyes of 3D. This expected allocation towards these types of companies is under the pretence that the fund's manager(s) will engage with investee companies on divesting from controversial and/or harmful activities, therefore driving positive change. Avoid Harm is weighted minimally within the Sustainability Improvers category.

Lead Change: Sustainability Improvers strategies typically focus on engaging with investee companies on their exposure to harmful impact activities, controversial activities, and overall ESG credentials. We believe that all groups should aspire to have strong and effective internal research processes, company culture credentials, and stewardship capabilities. At the fund level, the team can evidence how it is driving positive change through the fund stewardship questionnaire and the provision of supporting documentation. Lead Change is an important element of a Sustainability Improvers strategy and is therefore weighted significantly higher than Do Good and Avoid Harm.

Sustainability Focus

Do Good: Sustainability Focus strategies will typically aim to Do Good by investing in companies whose products and/or services possess relatively strong impact and/or sustainable characteristics than traditional funds. Additionally, these funds will aspire to have a high degree of exposure to activities aligned to the 3D Investing solutions classifications. Do Good is weighted equally to Avoid Harm but higher than Lead Change in order to account for the sustainability objective being targeted towards investing in sustainable solutions and minimising controversial activity exposure.

Avoid Harm: Sustainability Focus strategies typically aim to minimise investments in companies that provide products and/or services that negatively impact the environment and/or society, but also invest in companies that derive their revenue from activities that have minimal exposure to activities deemed controversial in the eyes of the 3D Framework. Avoid Harm is weighted equally to Do Good but higher than Lead Change in order to account for the sustainability objective being targeted towards minimising controversial activity exposure and investing in sustainable solutions.

Lead Change: Sustainability Focus funds will focus on engaging with investee companies on their exposure to harmful impact activities, controversial activities, and overall ESG credentials. Although 3D recognises that there is some degree of autonomy from the fund managers and their respective groups, we believe that all groups should aspire to have strong and effective internal research processes, company culture credentials, and stewardship capabilities. Lead Change is weighted less than Do Good and Avoid Harm in order to account for the sustainability objective being targeted towards investing in sustainable solutions and minimising negative externalities.

Sustainability Impact

Do Good: Sustainability Impact strategies aim to Do Good by investing in companies whose products and/or services have a direct intent to solve environmental and/or social challenges. Additionally, these funds will typically have a high degree of exposure to activities aligned to the 3D Investing solutions classifications. Do Good is an important element of a Sustainability Impact strategy, as investing in solutions-based companies is its core focus. Therefore, Do Good is weighted significantly greater than Avoid Harm and Lead Change.

Avoid Harm: Sustainability Impact strategies typically aim to minimise investments in companies that provide products and/or services that either negatively impact the environment and/or society, but also invest in companies that derive their revenue from activities that have minimal exposure to activities deemed controversial in the eyes of the 3D Framework. Avoid Harm is an important pillar of Sustainability Impact strategies; however, this is to a lesser degree than Doing Good. Avoid Harm is weighted significantly less than Do Good to account for this sustainability objective. It is, nevertheless, weighted the same as Lead Change.

Lead Change: Sustainability Impact strategies will focus on engaging with investee companies on their exposure to harmful impact activities, controversial activities, and overall ESG credentials. Although 3D recognises that there is some degree of autonomy from the fund managers and their respective groups, we believe that all groups should aspire to have strong and effective internal research processes, company culture credentials, and stewardship capabilities. Lead Change is an important pillar of Sustainability Impact strategies; however, this is to a lesser degree than Doing Good. Lead Change is weighted significantly less than Do Good to account for this sustainability objective. It is, nevertheless, weighted the same as Avoid Harm.

Step 7: Award of 3D Medal and Report Issued

The last stage of the 3D process is the award of a 3D medal (Gold, Silver or Bronze) based on the fund type and the issuance of a 3D report. A full explanation of each medal can be found within the 3D Guide to Medals document, which can be provided upon request.

A 3D report is comprised of 4-pages of information and commentary on the following:

- 3D medal
- Fund classification
- Fund summary
- Key fund facts
- 3D solutions breakdown
- Top 10 revenue activities
- Revenue-source sustainability analysis
- Controversial Activity & Harmful Impact exposure
- Company ESG review
- Fund stewardship review

Summary

The 3D Investing process takes a fund's portfolio and digs forensically into its sustainability credentials and how it aligns with the fund manager's sustainable objective.

By mapping all of a portfolio's revenue activities into specific 3D Investing classifications and attributing them, where applicable, impact and/or sustainable characteristics, the 3D Atlas database is able to measure the veracity of a fund's responsible investing claims. Additionally, the 3D Atlas database is able to measure and monitor any controversial and/or harmful impact activity exposure, which can then be brought to the attention of investors through our proprietary controversial screen. In every 3D rating, the 3D team will conduct a thorough investigation into the fund's and asset manager's ESG process and stewardship by issuing two questionnaires. Supplementing this is an annual ESG meeting, whereby the team will be able to validate and challenge the information provided in the questionnaire.

To this end, by assigning each fund a specific 3D framework that is aligned with its sustainable objective, 3D is able to verify and measure how well we believe a fund's manager is meeting its sustainable objective relative to its peers. This approach can be consistently applied to any portfolio, meaning that 3D ratings and certifications are a reliable and comparable assessment of a fund's RI credentials.



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