

For professional advisers only

An Introduction to ESG integration and Responsible investment in the UK Retail Fund Market

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Introduction

It is without question that 2019 was the coming of age for ESG and Responsible investment; new terms for many in the market, and ones that are having a significant impact. As with all new trends, however, there has been both confusion and misinterpretation within the industry and amongst investors, as well as much discussion as to whether this is a fad or the future. At Square Mile, we believe it is the future and, given how rapidly Responsible funds are being launched and ESG factors are being integrated into the investment processes of funds across all sectors of the market, we believe that, ultimately, the industry does too.

This seismic shift has undoubtedly been driven by three factors;

- The legislative and regulatory agenda, for example, legislation tackling climate change or corporate behaviour.
- Increasing investor and consumer awareness, as individuals seek to better understand how their money is currently being invested and how this could be brought in line with the other steps that they are taking to become more responsible citizens.
- The leaders of asset management businesses increasingly asserting the need for us as an industry to reconsider how we assess securities in order to truly ascertain their impact upon society and/or the planet and how we can improve this.

Referencing the impact of climate change, Larry Fink, Chairman and CEO of BlackRock, stated *'We are on the edge of a fundamental reshaping of finance'*, whilst the magnitude of change we are in the midst of has also been highlighted by Peter Harrison, CEO of Schroders. Mr Harrison stated that *"We [Schroders] think sustainability-driven investing will be one of the fastest growing and most exciting sectors in the coming years. Identifying investments which have a beneficial impact on society and the environment, as well as generating positive financial returns is of increasing importance to investors around the world. ... Impact Investing is going to be the biggest mega trend in our sector over the next two decades. I believe this is the blueprint for the future of our industry."*

Comments such as these from the industry's leadership, and the growing interest of consumers in understanding how their savings are being deployed, highlight the importance of building an understanding of ESG and Responsible investment to not only meet the needs of clients, but also to meet the incoming regulatory change. The changes are pursuant to Article 25 of MiFID II, with the European Commission currently seeking to amend Delegated Regulations to Articles 2, 52 and 54, which will require advisers to build an assessment of each client's ESG preferences into the suitability test. To help with this, in this document we seek to establish how we define ESG and Responsible investment, how they have evolved and what the embrace of the integration of ESG analysis and Responsible investment within the industry means for you and your clients.

How to define ESG and Responsible investment

2019 was abuzz with terms like ESG, as all elements of the asset management industry sought to embrace the sea change and meet investor and regulatory demand to become more responsible stewards of capital by focusing on the effect, either negative or positive, that their work could have upon society and the environment.

However, as with all new movements, there has been both confusion and misinterpretation as to what all the different terms, such as ESG, actually mean and how they impact upon funds and their managers' investment approaches.

So, before we go any further, we felt it imperative to define what ESG means and how it should be considered alongside the broader context of Responsible investment.

ESG is an acronym which stands for Environmental Social Governance and, as stated by Andrew Parry, Head of Sustainable Investment at BNY Mellon subsidiary Newton Investment Management, it should be seen as an input into the fundamental analysis done on companies by analysts and portfolio managers globally to better establish the potential risks of an investment and how best to mitigate them. Importantly, this analysis can be applied to any and all funds and is not just specific to funds with terms such as 'sustainability' in their name.

We would note here that when the new regulations are introduced, they will be accompanied by a taxonomy regulation. The taxonomy, or terms of reference, is being introduced to facilitate a consistent form of sustainable investment, and so the provision of standard definitions should assist in the adoption of common practice within the industry. So, we have provided details of the definitions that will be contained in the forthcoming taxonomy in the examples of ESG factors below.

As defined by the taxonomy, examples of ESG factors considered in company analysis include, for example;

- E** - "climate change mitigation, climate change adaptation, the sustainable use and protection of water and marine resources, the transition to a circular economy, waste prevention and recycling, pollution prevention and the protection of healthy ecosystems."
- S** - "investments that contribute to tackling inequality, that foster social cohesion, social integration and labour relations or investments in human capital or economically or socially disadvantaged communities."
- G** - "companies with sound management, employee relations and tax compliance."

When thinking about ESG, Andrew Parry's use of the word 'input' is key, because, contrary to what many have been led to believe by the misuse of terminology, ESG does not in itself produce a better outcome for either society or the environment. Instead, it is simply another lens through which to consider risks to a company and/or an investment thesis.

Therefore, whilst the consideration of ESG factors within company analysis could cause an analyst/portfolio manager to reconsider a position, or its weighting, due to a perceived risk, the use of ESG analysis does not engender:

- company/sector exclusions.
- a focus on companies which are helping the world transition to a more sustainable future.
- investment in companies/entities having a positive impact, such as a social housing project.

Instead, these areas fall under the umbrella term of Responsible investment.

Responsible investment differs from ESG analysis because it is focused on outcomes and what a fund is trying to achieve alongside, or other than, financial returns. In essence, we would say that these funds are not only focused on trying to achieve positive financial returns, but also have the ability to contribute to a positive outcome for society and/or the environment and/or to avoid harm.

At Square Mile, we categorise Responsible investment funds into three broad groups:

- **Exclusion** – funds which exclude companies or other entities which have a negative impact upon society and/or the environment.
- **Sustainability** – funds which reward and encourage positive change and leaders in sustainability.
- **Impact** – funds which actively include companies or entities which have a positive impact upon society and/or the environment.

However, it should be noted that some funds may employ more than one of the three characteristics in their investment approach.

In summary, ESG integration is an input into the investment process, rather than an output of it, whilst, Responsible investment is focused on trying to do good, avoid harm and deliver the desired outcome.

Now that we have defined how we interpret ESG and Responsible investment at Square Mile, we can move onto the primary focus of this document – what it all means for you and your clients. To establish the answer to this, we will be discussing the evolution of Responsible investment and ESG, the proposed suitability requirement and what it means in practice for you and your business and, finally, what we are doing at Square Mile. Also, if you would like some further information, we can provide you with our analysis of the impact of ESG/Responsible investment upon performance.

The evolution of Responsible investment and ESG

We wanted to give you an insight into the evolution of Responsible investment as a whole, in order to provide some context as to where the genesis of ESG and all of the modern forms of Responsible investment originated from.

Responsible investment is not a new phenomenon. In fact, various faith-based communities have influenced how people spend their money using ethical guidelines for centuries. For example, in 1758 the Quaker Philadelphia Yearly Meeting prohibited its members from participating in the slave trade. Whilst in his 18th century sermon, 'The Use of Money', John Wesley, one of Methodism's founding fathers, mandated what type of company his adherents could and could not invest in, thereby providing us with an early form of negative screening. Wesley's calls for the avoidance of 'sinful' companies that have a negative impact upon society can be seen echoed in the investment approach of funds today that use screening processes to remove the so-called 'sin stocks', such as tobacco, alcohol or defence-related companies, from their investment universes.

From the mid 20th century onwards, social and political movements also played a part in the evolution of Responsible investment, because, as the use of mutual funds became a more widespread practice, people sought to align their personal and political convictions with their investments. Moreover, they also began to realise the power and opportunity that shareholders have to influence company behaviours in order to produce a better outcome for society. It was from this backdrop that one of the first 'modern' ethical funds, the PAX World fund, emerged. A foundation stone of Responsible investment globally, this fund was launched in 1971 in the USA by Luther Tyson and Jack Corbett, employees of the United Methodist Church, in part to protest against the Vietnam War and the American companies profiting from it and, more broadly, as a mechanism to encourage companies to both create and meet fixed standards of social and environmental responsibility.

Meanwhile, in the UK the popularity of Responsible investment, or, as it was traditionally named, ethical investment, accelerated in the 1970s and 1980s. Driven by concerns of the Apartheid in South Africa, both individuals and public and private institutions divested from companies operating in the country in protest against the regime and its horrific impacts. As part of this, EIRIS, the UK's first independent research service for ethical investors, was established in 1983. A year later, we saw the launch of the UK's first ethical retail fund, the Friends Provident Stewardship Life fund, which was followed in 1987 by the UK's first environment focused fund, the Jupiter Ecology fund. Following this, in 1990, one of the first Responsible investment focused indexes, the Domini 400 Social index, was launched in the US, and in 1991 the UK Social Investment Forum (UKSIF) was established. By 1996 there was over £1 billion held in UK retail ethical funds and in 1998 the UK published the world's first Corporate Governance Code; a set of standards of good practice for listed companies .

These developments continued apace as we entered the 21st century, when, in 2000, an amendment to the 1995 Pensions Act made it law that the trustees of occupational pension schemes had to declare whether or not they had taken social, environmental or ethical factors into account when making investment decisions. By 2004, the assets held in UK retail ethical funds had reached £5 billion and, in 2005, there was a key advancement in the form of the Freshfields United Nations Environment

Programme Finance Initiative Report. The UNEP FI is a global partnership between the United Nations Environment Programme and organisations within the finance sector that aims to develop and promote links between the environment, sustainability and financial performance. At this time, one of the main focuses of the UNEP FI's Asset Management Working Group was that "despite the growing body of evidence that Environmental Social Governance (ESG) issues can have a material impact on the financial performance of securities and an increased recognition of the importance of assessing ESG-related risks, those seeking a greater regard for ESG issues in investment decision-making often encounter resistance on the basis of a belief that institutional principals and their agents are legally prevented from taking account of such issues." This report was therefore key to the ongoing evolution of Responsible investment because it put into place the legal framework through which asset managers could consider and/or integrate ESG factors in their investment processes.

This report was followed a year later by the launch of the United Nations Principles of Responsible Investment (UN PRI), which is a global investor initiative working in partnership with the UNEP FI and the UN Global Compact. The first of its kind, this initiative seeks to support the integration of Responsible investment practices within the global investment industry by helping its network of signatories, including asset management groups, pension funds, etc, incorporate ESG factors into their investment processes and decisions by way of its six Principles for Responsible Investment, outlined below, to which its signatories commit.

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time).

We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

- Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.
- Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.
- Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.
- Principle 5: We will work together to enhance our effectiveness in implementing the Principles.
- Principle 6: We will each report on our activities and progress towards implementing the Principles.

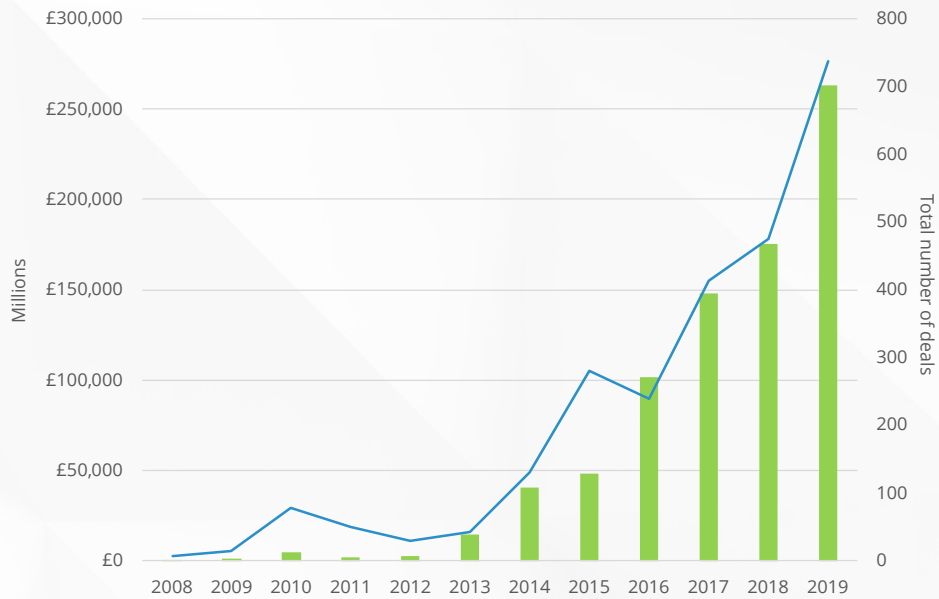
The Principles for Responsible Investment were developed by an international group of institutional investors reflecting the increasing relevance of environmental, social and corporate governance issues to investment practices. The process was convened by the United Nations Secretary-General.

In signing the Principles, we as investors publicly commit to adopt and implement them, where consistent with our fiduciary responsibilities. We also commit to evaluate the effectiveness and improve the content of the Principles over time. We believe this will improve our ability to meet commitments to beneficiaries as well as better align our investment activities with the broader interests of society.

Source: [UN PRI Website](#)

In 2008 the World Bank, an organisation comprised of five institutions established in 1944 to reduce poverty and support development, issued the first labelled green bond. A green bond is a bond whose proceeds are ring fenced for either climate or environmentally focused projects. It is usually asset-linked and is essentially intended to financially support projects that are helping in the fight against climate change, such as the construction of solar power plants. The chart on the next page shows the increase in the issuance of green bonds from 2008 to the end of 2019.

Figure 1: Green Bond Market Size



Source: Bloomberg

2015 was another milestone in the world of Responsible investment, with the launch of the United Nations Sustainability Development Goals, known as the UN SDGs, which are illustrated in the image below. These 17 development goals have been adopted by all of the United Nation Member States and aim to provide countries and their governing bodies with a blueprint to “end poverty, protect the planet and ensure that all people enjoy peace and prosperity by 2030.” The goals are purposefully high level in their nature, so as to capture all of the most critical issues facing the world’s populace, and are also integrated in recognition of the fact that in order to truly achieve one goal, the others must be met too. To ensure that the goals are being met, there are 169 associated targets, which are measured using 232 indicators of achievement.



Source: UN SDG Website

The UN SDGs have been adopted by many asset management groups in the UK as either a thematic or stock selection basis for their various Responsible investment products or as a way of demonstrating to the investors what the fund might be trying to achieve or its intended impact. We would note that as the 17 UN SDGs were developed for countries and/or governments they might be slightly too broad for use at a fund level and might instead be better as more of a foundation stone of an investment approach.

In a clear demonstration of the asset management industry’s evolving attitude towards Responsible investment, two years after the launch of the UN SDGs came an investor initiative known as the Climate Action 100+. Comprised of over 370 investors globally with a collective assets under management of c. \$35 trillion, Climate Action 100+ was established to take on the world’s largest corporate greenhouse gas emitters and pressure them into changing their behaviours, improve their standards of governance and, ultimately, reduce their emissions, in order to ameliorate their impact upon the environment.

The market today

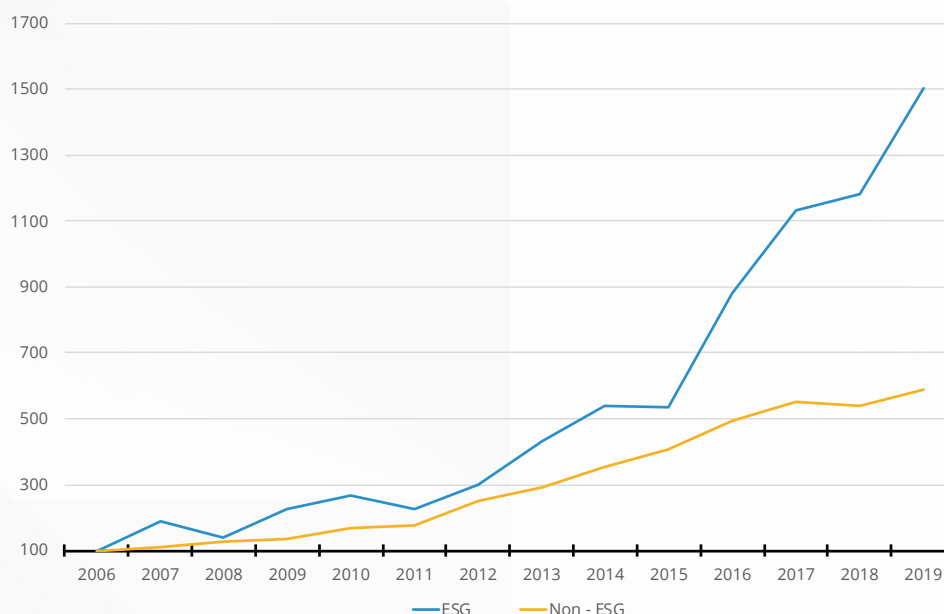
Pleasingly, by 2019 it seemed as though we were starting to reach a new normal. Many firms committed to integrating ESG analysis into the investment processes of all their funds and sought to launch, or did launch, some form of Responsible investment fund, the number of signatories to the UN PRI hit the 2500 mark, the CFA Institute launched an ESG Qualification, and green bonds hit \$1 trillion in assets. Also, in October 2019, the Business Roundtable, a prestigious association of American chief executives, shook up the business world by releasing a statement signed by 200 CEOs, which redefined the purpose of a company. Indeed, for as long as anyone can remember, the primary focus of public companies has been to increase shareholder value. However, the association said that companies should now also be looking out for the interests of customers, workers, suppliers and communities, with the aim being to increase diversity and protect the environment. Moreover, as the following analysis demonstrates, there has been a dramatic increase in investor demand for Responsible funds.

The growth in AUM

The following charts are based on data from FE Analytics as of the end of December 2019. A screen of funds, available to purchase in the UK, in both the IA and the FCA recognised universes, was run in order to find funds following Responsible investment related methodologies, with all passive/tracker funds having been removed. Initially, 8884 funds were screened using a key-word search. If words such as: ESG, responsible(y), sustainable development, sustainable equity, carbon, climate, environmental(ly), green bond, renewable energy, ethical(ly), social(ly) or SRI were mentioned anywhere either in a fund's name or a fund's description then the fund would be flagged up. All positive hits were then checked for appropriateness so to avoid any false positives and, in the end, 338 actively managed funds were identified.

Figure 2 illustrates the investors demand for Responsible investment funds by showing the growth of assets under management. The two cumulative series of data are made of equally weighted constituents for each group i.e. Responsible investment and non-Responsible investment funds. Both series were rebased to a value of 100 for year 2006. The chart shows a clear demand for Responsible investment solutions, where the size of assets under management for Responsible investment funds starts to grow at an increasing rate compared to their non-Responsible investment counterparts. Although in absolute terms the size of the Responsible investment universe is magnitudes smaller than that of non-Responsible, the growth seen in this sector is fast gripping the financial industry.

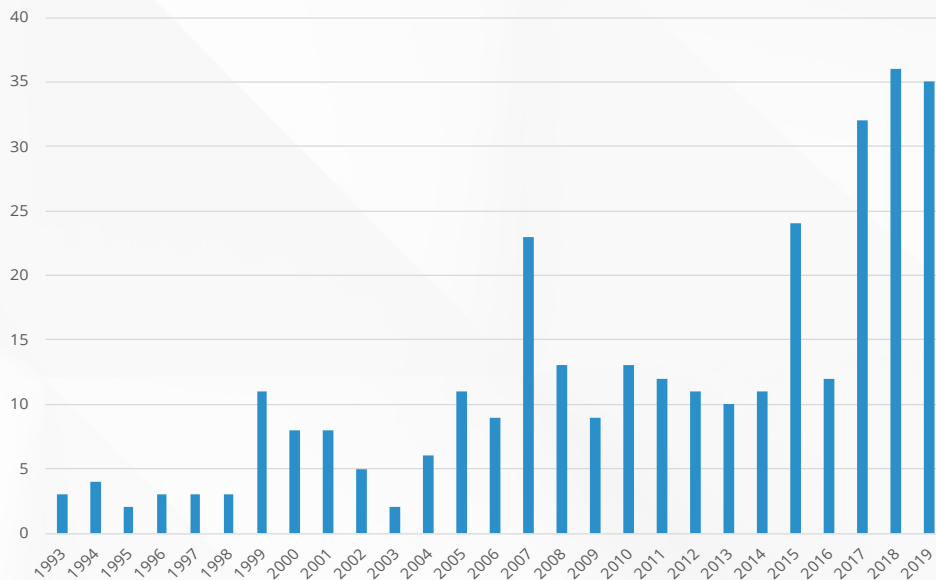
Figure 2: Assets under management growth ex passives



Source: FE Analytics

Figure 3, meanwhile, shows the average number of funds launched in each consecutive calendar year since 1993. The average number of funds launched per year with some relationship to Responsible investment has increased from 3 in the 1990s to 20 in the 2010s. However, in the last 3 years alone the average number of launches rose to 34 funds.

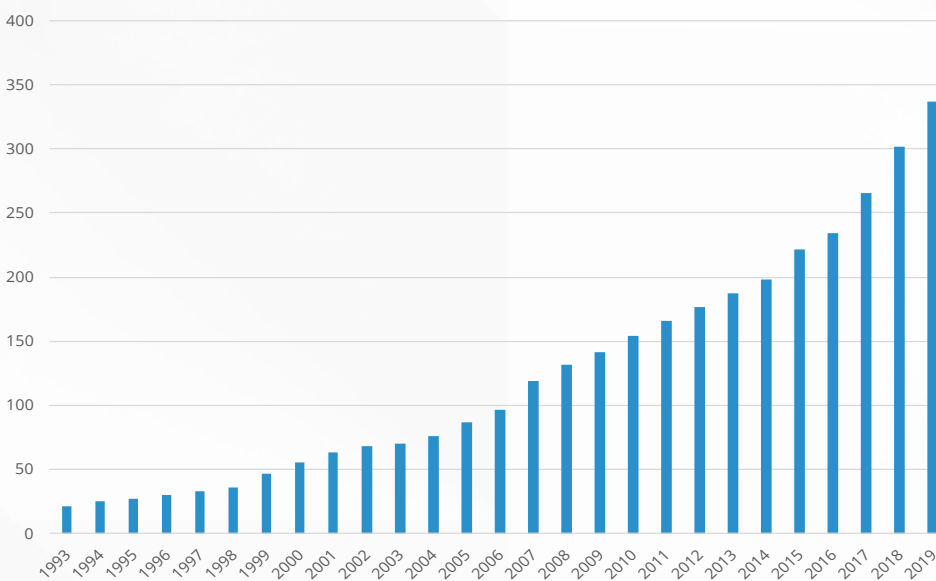
Figure 3: Average number of Responsible fund launches per calendar year



Source: FE Analytics

The strength of this trend is made even clearer when the number of Responsible investment fund launches are normalised to a total number of funds launched that year, which is shown in the Figure 4, below.

Figure 4: Total Number of Responsible funds



Source: FE Analytics

The proposed Suitability Requirement

The European Commission's Action Plan on Sustainable Finance in 2018 led to a raft of EU proposals on legislation to help embed ESG issues into the governance standards across the finance sector. These proposals will have a material impact on certain components of the EU Financial Service regulatory framework, especially as the EU believes that the asset management sector is crucial to the advancement of its ESG agenda. The most recent proposal are the changes pursuant to Article 25 of MiFID II, with European Commission currently seeking to amend Delegated Regulations to Articles 2, 52 and 54, which covers the provision of investment advice and suitability.

Given the election of a Conservative Government in the UK in December 2019, with a clear majority and therefore a mandate to deliver Brexit, there has been speculation that these regulations may not be introduced in the UK. However, many informed commentators believe that, even with Brexit, this regulation will still apply because the UK regulator wishes to maintain regulatory equivalence for a period of time. In addition, asset managers globally are keen to have regulatory consistency on this important issue. It is therefore imperative that both advisers and asset managers prepare for the introduction of some form of this requirement in the early part of 2021.

What does this mean for Advisers?

At the time of writing this paper the exact requirements had not been released. However, there is guidance that we can draw upon gathered from the various leaks and consultation papers. According to the aforementioned, companies completing a suitability review will need to complete assessments along the following lines;

- The adviser should disclose, where appropriate, information on the ESG characteristics of each individual financial product under consideration, before finalising recommendations.
- Companies providing portfolio management services will be required to explain how the client's ESG preferences were accounted for in the selection of holdings for a portfolio.
- Companies will need to explain how the client's ESG preferences were considered in the financial advice process.

Therefore, whilst not finalised, there are very strong indications that a review of the current processes in place will be required, which will lead to the need for staff training and changes to the review of client materials. Do not panic, there is still time. However, we would encourage you to begin a review of client material, your current approach and the solution offered in order to understand what may need to be changed or adapted.

What we are doing at Square Mile

Given how subjective this area can become and all the confusion in the market, there is often the issue of how best to match a fund to a client's needs. To help with this and hopefully provide some clarity, Square Mile has launched two separate initiatives; ESG Assessments which are applied at both fund and company level and Responsible ratings which are awarded to funds that are managed using some form of Responsible investment mandate.

The ESG research process and assessments

As alluded to at the start of this paper, the consideration of ESG factors is of growing importance in asset management, with successful approaches increasingly being used to great advantage both to enhance returns and, perhaps more importantly, to understand and manage risk. Furthermore, the consideration and integration of ESG factors is of interest to a growing number of investors and so to enable investors to better understand how their investments are managed, Square Mile has developed an approach to analysing and articulating the various approaches to ESG integration that inform the investment processes of the funds that we rate.

Our research team analyses ESG integration at two levels for each of the funds that we rate.

Firstly, at the company level we seek to understand if and how an asset manager integrates the consideration of ESG factors in 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 whether its left to individual teams and managers to determine their own approach.

Secondly, at the individual fund level 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.

This is a qualitative assessment. Every company and fund 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 in order to cut through the terminology and make sense of the facts.

We grade each company and fund on a scale of 0 to 3, in accordance with the definitions below. The choice of a scale of 0 to 3, rather than 1 to 4, was quite intentional, as a score of 0 sends a very strong message to both fund managers and fund buyers alike. These scores are not necessarily linear.

Company level ESG Integration

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.

Fund level ESG Integration

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.

Square Mile's Responsible ratings

At Square Mile, we recognise that not all of the benefits of investment have to be monetary and realise that an ever-growing number of investors are seeking funds that have a dual objective of positive financial returns and the ability to contribute to a positive outcome for society and/or the environment.

An example of this could be the performance objective of the Square Mile Responsibly AA rated Threadneedle UK Social Bond fund, which is as follows: "To at least match the performance of the benchmark, the ICE BoA ML Sterling Non Gilts 1-10 Year index over the long term (which we consider to be at least 5 years), whilst providing better social outcomes."

However, finding funds that meet these objectives is not necessarily straightforward. It is for this reason that we have looked to complement our existing ratings process by introducing Responsible ratings, which should help advisers identify funds that can

fulfill their client's aim to invest in funds that have a positive impact on both their own financial wellbeing and on the wellbeing of the world around them. We would note that our Responsible ratings are also in line with the IA's framework that was recently issued to provide guidance on the language in this area to make it as easy as possible for advisers to interpret.

These ratings denote a fund that is best in class in its area and fall into one of these three broad categories outlined previously:

1. **Exclusion:** excluding companies or other entities which have a negative impact on society or the environment.
2. **Sustainability:** rewarding and encouraging positive change and leaders in sustainability.
3. **Impact:** inclusion of entities which have a positive impact on society or the environment.

The Responsible ratings are an evolution of our existing ratings methodology and are fully integrated into our research team's process. We do not believe that Responsible investments should be viewed separately from more 'mainstream' funds, therefore Responsibly rated funds undergo the same robust assessment process that we apply to every other fund in our Academy.

We assess each and every fund that we look at against the outcome that the manager articulates that they are seeking to achieve, and we expect the funds qualifying for a Responsible rating to have many of the same characteristics we expect from all of the funds that we recommend to our clients. This includes a clearly articulated philosophy that looks to exploit identified inefficiencies, a proven and repeatable process, a sound management team, an environment conducive to meeting the fund's objectives, solid portfolio construction, a stringent risk management framework and a cost which fairly reflects all of these other considerations.

For a fund to achieve a Responsible rating we would expect it to offer a result that, whilst not always measurable by traditional means, meets the Responsible investment aspiration of the client, in addition to its financial goals. This could come in many forms but should largely fall within the three categories of responsible funds that we have identified above.

We are aware that the usual ways of measuring funds may need to be adapted in some cases, for example, benchmarks may be less relevant and risks may be different from similar funds not employing an overly responsible approach. We will assess each and every fund on a case-by-case basis, gaining a thorough understanding of the fund's responsible outcomes and its ability to deliver these. Whilst we view ESG factors as a separate assessment, it is undoubted that they are often a valuable input in helping to frame our understanding of the fund manager's approach to Responsible investment.

In summary, the Responsible ratings enable our analysts to recognise and acknowledge the potential of these funds to deliver more than financial returns by assessing the ability of such funds to meet both their financial and positive societal and/or environmental outcomes. The Responsible ratings run along the same scale as our standard ratings, with gradations that express our confidence in a manager's ability to meet their objectives. The only difference between the two scales is that responsibly rated funds will have a responsible outcome or target incorporated into their objectives or mandate, and our expression of confidence is in the manager's ability to meet both aspects of their objectives.

	<p>Assigned to funds in which we have the greatest confidence that the fund over an investment cycle will meet its stated objectives.</p>		<p>Some funds meet the highest standards in their fields, however, beyond this the funds cannot be readily differentiated between each other. An example would be passive funds. Such products will be assigned a recommended rating.</p>
	<p>Assigned to funds in which we have a high confidence that the fund over an investment cycle will meet its stated objectives.</p>		<p>Funds which our researchers have identified as up and coming interesting propositions. However, the manager, their strategy or their process is new and has not been thoroughly tested in all market environments. As a result we are not in a position to provide a full fund rating. Instead we are producing a qualified rating to highlight the fund's potential but also recognise Square Mile's reservations.</p>
	<p>Assigned to funds which we have confidence that the fund over an investment cycle will meet its stated objectives.</p>		

What is next?

It is unclear how exactly the market will continue to evolve, as there are currently so many different approaches being employed and launched, at both a company and a fund level. Hopefully with the introduction of the new regulations, and within that, the taxonomy, there will come a greater understanding of terminology across the industry, and more consistency of thought applied to investment approaches and processes, as well as to the measurement of a fund's output.

Indeed, it seems likely that investors will become both more discerning and more demanding in their hunt for funds that truly meet the duality of their stated performance objectives in order to be sure that their investments are delivering positive performance for both them and for society and/or the environment. Consequently, advisers will have to be very certain of their clients' ESG or Responsible investment preferences, whilst asset management groups are going to have to be much clearer as to what exactly they mean when they label a UK equity fund as sustainable, for example. They will also have to provide much more clarity as to what investors could or should expect from a fund with sustainable or responsible objectives.

In terms of Square Mile's journey, we thought the best way to shine a light on what may come is to share with you what has happened since we launched the ESG Assessments and Responsible ratings in October 2019.

- We have been contacted by a number of IFAs and other organisations seeking help in the development of a process through which they can encompass ESG into their centralised investment process. This work is still at an early stage but is progressing well.
- We are in the throes of constructing portfolios for a number of clients, something which has been difficult due to the limitations placed upon the investment universe by the lack of available funds.
- We have been asked to construct buy lists that only feature Responsible funds. Although possible, this is also proving to be rather challenging, as the number of funds available in this space is still limited, despite the pipeline of new launches growing at a significant rate.

There is, as you can see, no simple solution and we will all need to maintain a watchful eye on the regulations as they become available and the impact that they will have. However, this uncertainty is not an excuse to do nothing. Instead, we believe that it is very important to:

- Begin discussions with clients both new and existing, as to what their ESG and/or Responsible investment preferences are.
- Identify a partner or an information source you can work with to help you develop your ESG and/or Responsible investment offering.
- Encourage all members of the business to begin to read up on this area as, given it is so dynamic, the more people monitoring developments the better.

We firmly believe that the impending regulations necessitating that advisers build an innate understanding of their clients' ESG preferences will be a defining moment in the journey of our industry. The importance of this regulation, which will require ESG factors to be a key part of all an adviser's client reviews and new business discussions, combined with the rise of consumer awareness and the political push, will make ESG factors integral to all discussions relating to financial products. In essence, the popularity of the integration of ESG analysis and Responsible funds reflects an inflection point for the industry. Indeed, we think it may well be the case that in 3 to 5 years' time, the integration of ESG analysis will have become hygiene in asset management processes, that Responsible funds will have become the primary money takers and that the current 'mainstream' funds will have become niche. This may seem far-fetched, but when one considers the speed at which ESG and Responsible investment have taken hold, it seems unlikely that the focus on this area is going to diminish any time soon. We would encourage you to embrace this seismic change, if not you may well fall victim to the transition.

We would welcome the opportunity to share our thoughts on a pragmatic solution to the incoming regulations with you.

For more information please email us at
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