

3D Methodology

2021



Understanding our definition of Responsible Investment (RI)

RI has become an increasingly powerful force within our industry in recent times. This has been accelerated by our latter collective experiences through the Covid-19 pandemic and an increasing awareness of the global climate crisis and deepening social disparities.

From both a government and investor perspective, there is an increasing focus on the need for a kinder form of capitalism. This is borne out in the call to action to do more to benefit and protect the communities and environment in which we live and work.

However, as is evident, this has come with inconsistency and confusion around language, terminology, and communication more broadly. It has also revealed differences in the interpretation of these very subjective areas and what they constitute in terms of investment.

In terms of our work, one of our primary aims is to help our clients meet their clients’ aspirations and liabilities. Integral to this is enabling our clients to understand new market trends or movements by providing clear and in-depth research.

Clarity is key. To be wholly committed to trying to break down and eliminate the confusion stemming from the misuse of language or terminology, we need to establish clear, meaningful, and sensible definitions.

At Square Mile, we see RI as an umbrella term which is underpinned by the 3D Framework of “do good”, “avoid doing harm” and “lead change”. From this stem four broad categories of investment approaches which we outline in the summary below. Many funds adopt more than one of these approaches, but we identify the one we believe is most material for the underlying fund. The four approaches are defined as follows:

Responsible Investment



Ethical Exclusions

An ethical exclusions fund manager seeks to avoid industries and company practices that cause harm to people or the planet.



Sustainable Solutions

Sustainable funds are those which are helping enable the transition to a more sustainable world. Examples of this could include investment in companies which are enabling or delivering solutions to environmental, social and economic challenges, as well as those which are evolving their operations and products or services. It can also encompass thematic funds, which are focused upon a particular issue, such as the energy transition.



Impact Investing

Impact funds display a clear intent to deliver a positive social and/or environmental impact by investing in companies providing solutions to the world’s most pressing challenges. This should be demonstrated through the achievement of measurable outcomes, which are clearly evidenced and reported on at least an annual basis.

The 3D Framework

To qualify for a rating, RI funds are assessed against the 3D Framework outlined above. This framework highlights the pillars that are critical to effect positive change in relation to the world's most pressing environmental and social challenges.

The definitions

| Do good | Avoid doing harm | Lead change |
|--|--|---|
| Investment in companies offering solutions to global social and environmental challenges and evidence of impact. | Avoidance of investment in companies making a significant negative contribution to society and the environment and those exposed to controversies. | 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. |

What this means in practice

During the assessment, funds will receive a score out of five for each of the three pillars and the overall score will dictate which rating they receive.

We would note here that whilst we would typically expect the gold and silver ratings to be awarded to impact and sustainable solutions funds, we are very cognisant that we are catering to a broad range of investor aims and that not all funds solely seek to deliver a positive impact.

We seek to assess a fund across the four approaches we have identified and believe that our framework and its three pillars of assessment enables this. For example, although an ethical exclusions fund may not score well on the 'do good' pillar, it could still qualify for a Bronze rating, if it scored well in 'avoid doing harm' and 'lead change'.

The ratings

No rating

No rating – The fund did not meet our minimum standards.



REVIEWED

Reviewed – A reviewed fund may demonstrate some investment in solutions but this will typically not be its primary focus. As such, the evidence of impact outcomes is likely to be limited. There may be some evidence of screening criteria applied but this could be restricted in scope and so there may be some exposure to ethical controversies. Engagement activities and reporting, meanwhile, will usually be focused at a group level.



BRONZE

Bronze - A Bronze rated fund will typically have some focus on investment in solutions to social and environmental challenges, as well as some evidence of impact but this can vary in standard and scope. There may be some exposure to ethical controversies. Depending on the RI approach applied, there may also be some systematic engagement.



SILVER

Silver - A Silver rated fund will have a high focus on investment in solutions to social and environmental challenges, as well as systematic reporting on environmental and/or social metrics across the portfolio. Typically, there will be a low level of exposure to ethical controversies due to informal or formal screening policies. The manager will typically demonstrate systematic engagement on social and environmental issues at an individual holdings level and participation in collaborative and educational initiatives.



GOLD

Gold - A Gold rated fund will have a very high focus on investment in social and environmental challenges and a very low level of controversies due to formal or informal screening policies. There will be a clear intention to make a positive social and environmental impact with systematic reporting to demonstrate these outcomes. The manager should also systematically engage on social and environmental issues at both an individual holdings level and as part of collaborative and educational initiatives.

The Process

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 an RI focused objective reflected in its mandate and have a clearly articulated philosophy and process which 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 a responsible practices manager is defining and encouraging 'best practice'. We would also expect the fund manager to be open and accountable in providing information and evidence that they are meeting their RI objectives and intentions.

To be eligible for a 3D rating, funds have to be registered for sale in the UK.

Gather Information

The assessment of funds against the 3D Framework is based on evidence, with all fund managers and their products undergoing a detailed examination of their holdings, policies, and practices in respect of the three pillars.

We provide fund managers with a questionnaire which must be completed and returned, along with the requested supporting documents, before assessment can take place.

Within the questionnaire, we ask for the current fund holdings. The minimum information required is the security ID code, security name and portfolio weighting. However, we also expect that a fund manager should be able to justify any holding in their portfolio and, where possible, we request an impact justification for each holding. This is not a compulsory requirement but does help to evidence the impact of a fund.

The questionnaire also accounts for the following:

- **Approach** – which type of RI approach is adopted by the fund manager
- **Validation & Data** – information on any committees, memberships of RI initiatives, external validation and data subscriptions or providers
- **Exclusions** – the extent of the exclusion criteria employed by the fund manager
- **Influence** – information on engagement, voting and advocacy activities undertaken by the manager
- **Environmental and Social Metrics** – data on the environmental and social footprint of the fund
- **Impact outcomes** – the tangible impact outcomes achieved by the fund, for example, how many megawatts of clean energy has the fund generated, or how many people have received treatment or been provided with affordable housing?

When it comes to the environmental and social metrics as well as the impact outputs, we recognise that not all fund managers will be able to provide this information and that it is currently hard to measure these areas consistently and comparably. However, we ask them to provide us with any evidence or information possible and an overview of how they came to these conclusions.

In the 'basics' tab we have included a list of supporting documents which we would ideally like to receive along with the questionnaire.

Supporting documents:

- | | |
|---|--------------------------|
| - Impact Report | - Holdings Justification |
| - ESG or Sustainability Report | - The most recent RFP |
| - Ethical Exclusions Criteria | - A fund presentation |
| - Engagement or Stewardship Report | - UN PRI Report |
| - EU Sustainable Financial Disclosure Documents | |



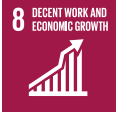




Analysis

The 3D Investing Database:

The 3D Investing Database currently includes circa 4,000 companies but over 100,000 securities. The holdings of every single portfolio we analyse are run through the database, researched, and classified into one of the following five categories according to the amount of revenues derived from the core product or service that they deliver.

Positive Solutions:

The company's core products and/or services deliver a solution to social and/or environmental challenges. We have identified 12 different types of positive solution which represent the themes captured by the United Nations Sustainable Development Goals (UN SDGs).

| | | | | | | |
|---|--|---|---|--|---|---|
|  | Circular Economy: Waste management and recycling, environmental consultancy |  |  | Natural Capital: Water Supply & Sanitation, Water Filtration, Air Filtration, Forests | | |
|  |  | Education, Jobs & Learning: Educational publishing, educational establishments, training | |  | Renewable Energy: Solar, Wind, Biomass, Hydro | |
|  | Enabling Infrastructure: Platforms and technologies that are key parts of moving to a sustainable world. These include electrical transmission networks, cloud infrastructure and 3D printing | |  | Resource Efficiency: Energy Efficiency, Natural Resource Efficiency, Waste Management & Recycling | | |
|  | Healthcare: Medical Equipment, Pharmaceuticals, Health Services | |  | Safety: Cyber security, building and automotive safety, food safety | | |
|  |  | Inclusive & Ethical Finance: Microfinance, Sustainable Investment & Ethical Banking, Peer to peer lending, Municipal finance | |  |  | Social Infrastructure: Housing – Social, Student, Care Homes; Healthcare – Hospitals, Dental & GP Surgeries; Education - Schools, Libraries & Universities |
|  | Low Carbon Transport: Train & Tram operators, Bus & Coach operators, Bicycle manufacture, Electric Vehicles, Rail Infrastructure | |  |  | Sustainable Food: Food storage, food safety, Reduction in non renewable inputs for farming, renewable farming alternatives, organic and high welfare food manufacture and distribution | |

Limited Positive Solutions

The company's core products and/or services neither present a solution to social and/or environmental challenges nor deliver a major level of harmful impact.

Harmful Impact

The company's core products and/or services deliver/ contribute a major harmful impact to society and/or the environment.

Public Finance

Government bonds etc., which do not have proceeds specifically linked to environmental or social projects such as Green bonds.

Other

This typically represents a very small percentage of the portfolio and usually consists of financial instruments such as futures or stocks that we have been unable to classify due to technical issues like a security number.





















Cash

This includes physical cash and short-term money market instruments.

This process enables both our clients and us to identify how much of a portfolio is exposed to companies either positively or negatively contributing to the UN SDGs and, by consequence to society and the environment. The positive solutions are mapped to the UN SDGs, so that the contribution of the fund to the SDGs can be identified.

It also forms part of our analysis and assessment, especially in relation to 'do good' and 'avoid doing harm'. Indeed, in relation to the doing good pillar, where a large proportion of a portfolio contains holdings which constitute solutions to social and environmental challenges, a fund will likely score strongly.

When it comes to the ‘avoid doing harm’ section, we seek to identify a fund’s exposure to controversial activities and practices; specifically those which we believe a high negative contribution to the achievement of the UN SDGs, as defined below. If a fund contains material levels of securities which have a harmful impact, it will likely not score as well in this part of the assessment.

| Addiction | Animal Welfare | Environment | | Fossil Fuels | | Human Welfare |
|---|--|--|---|--|---|---|
|  Alcohol |  Animal Testing |  Inorganic Fertilisers |  Pesticides |  Power Producers |  Exploration & Production |  Human Rights (Countries) |
|  Gambling |  Animal Products |  Mining |  Tropical Forests |  High Carbon Industries |  Petrochemicals |  Human Rights (Companies) |
|  Tobacco |  Meat & Dairy Production |  Nuclear Power | |  Distribution |  Service Industries |  Military Weapons |

We would note here that not every security in a portfolio can be initially matched to the 3D Investing Database. For example, often fixed income securities have multiple issues, whilst shares may have different regional listings. The aim is to match 100% of a portfolio’s holdings to the 3D Investing Database. Therefore, what are initially classified as unrecognised instruments will either be mapped to existing companies, as in the case with shares with different regional listings, or will be analysed and classified accordingly.

However, there may be instances where this is unable to occur as not all securities are compatible with this analysis, such as financial derivatives. These will be categorised as ‘other’ and will not be counted towards solutions or any other category.

Once this has been completed, the classification report is run and provides us with the percentages of the portfolio as now defined by the 3D Investing classifications.

In order to monitor controversies and classify securities in the database, we use data sourced from third party subscribed services, publicly available information, as well as the information provided by fund groups in the completed questionnaire and supporting documentation.

The assessment framework

Once we have received the information from a fund group and the report from the database, we begin to assess the fund against the 3D Framework.

In each of the three pillars, we have identified key factors against which we measure funds. For example, in the ‘do good’ section we look at the extent of the fund’s investment in positive solutions in comparison to its 3D benchmark and how it is evidencing the positive change it is trying to affect.

In the ‘avoid doing harm’ section, meanwhile, we consider the breadth of the exclusions applied by the fund manager, as well as the fund’s exposure to controversial activities and practices.

Finally, under the ‘lead change’ pillar, we analyse how a fund manager is exercising their influence via engagement and advocacy at both in terms of individual holdings and in a broader sense, such as industry level initiatives.

As outlined above, the fund will receive a score out of five for each of these three sections, which are then added together to achieve the fund’s rating. We will also produce a data rich report, providing our clients with a summary of our view of the fund’s strengths and weaknesses in respect of each part of the 3D Framework. This will also be published on our website. An example report can be provided upon request.

Summary

In summary, the investment industry has seen a seismic shift towards RI, with a multiplicity of funds claiming to invest positively or with impact. The growth in the market and diversity of approaches has led to widespread accusation of 'greenwashing'.

3D Investing aims to meet this challenge by reviewing funds against the 3D Framework of 'Do good, avoid doing harm and lead change,' and enabling investors to make an informed investment decision by providing them with independent and evidence-based analysis of a fund's impact, both positive and negative, on society and the environment.



Important Information

This brochure is for the use of professional advisers only. It is published by, and remains the copyright of, Square Mile Investment Consulting and Research Ltd ("SM"). SM makes no warranties or representations regarding the accuracy or completeness of the information contained herein. This information represents the views and forecasts of SM at the date of issue but may be subject to change without reference or notification to you. SM does not offer investment advice or make recommendations regarding investments and nothing in this brochure shall be deemed to constitute financial or investment advice in any way and shall not constitute an invitation or inducement to any person to engage in investment activity. Should you undertake any investment activity based on information contained herein, you do so entirely at your own risk and SM shall have no liability whatsoever for any loss, damage, costs or expenses incurred or suffered by you as a result. SM does not accept any responsibility for errors, inaccuracies, omissions or any inconsistencies herein.