

RESPONSIBLE INVESTMENT

# **Incorporating responsible investment preferences into your investment choices**

*A guide for advisers and investment managers*

SPECIALISTS IN INVESTMENT MANAGEMENT

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# Responsible investment at Quilter Cheviot

## What do I need to think about?

Every client has their own requirements around risk appetite, ability to bear loss, income requirements as well as the investment time horizon. These are the key areas that will determine what is the right investment approach for your client. Please refer to our **Understanding Your Investment Portfolio** document for more information on this. There is now a further area that we are including within the regular process of ensuring that investments meet clients' requirements, through the suitability cycle. We will now be asking clients about their responsible investment preferences.

The only service which is not included is Execution Only.



# What is responsible investment?

This is how the United Nations backed Principles for Responsible Investment (PRI) defines it:

*“A strategy and practice to incorporate environmental, social and governance (ESG) factors in investment decisions and active ownership”*

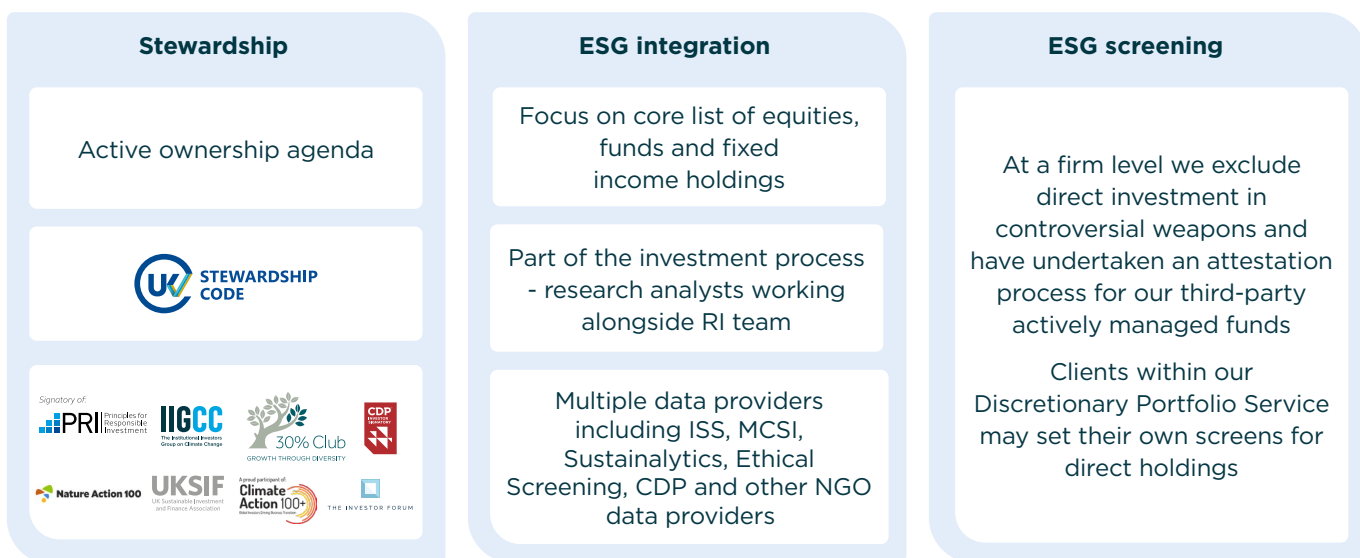
At Quilter Cheviot our responsible investment approach includes active ownership (stewardship), the consideration of environmental, social and governance factors within the investment process (ESG integration) as well as positive and negative screening based on specific factors (ESG screening).

This applies across our:

- Discretionary Portfolio Service (DPS)
- Managed Portfolio Service (MPS)
- Advice and Dealing service (A&D)
- The Funds that we manage (including Climate Assets Funds\*, Quilter Investors Ethical Fund, Libero Balanced and the Quilter Cheviot Global Income and Growth Fund for Charities)
- Our advisory service
- The AIM Portfolio Service

Some of the strategies include positive and negative screening, clients may have additional requirements which they should discuss with their investment manager.

This is the approach Quilter Cheviot takes to responsible investment across the services mentioned above:



For more information, please visit: <https://www.quiltercheviot.com/our-services/responsible-investment/>

*This applies to centrally monitored holdings only. Your Investment Manager has the flexibility, within a controlled framework, to tailor your portfolio with regard to asset allocation and security selection, in order to accommodate your investment requirements.*



# What are the options

We have identified three client preference categories: **Aware**, **Engaged** and **Dedicated**.

For existing clients, we have categorised these in accordance with their current investment strategy, however the adviser/investment manager will review this with the client at the next regular meeting.

For example, if the client already invests in Climate Assets Funds\* or strategy then this would be aligned to the Dedicated category; similarly, for Positive Change this would align to the Engaged category. The majority of clients will be aligned to the Aware category.

The Aware category reflects the Quilter Cheviot firmwide approach to responsible investment which incorporates stewardship (voting and engagement) as well as integration of ESG considerations within the investment process. If financial factors such as tax preclude the client from moving to another category, then we will continue to treat them as Aware.

## How would you describe your preferences for responsible investment considerations?

Quilter Cheviot recognises the importance of integrating Environmental, Social and Governance factors (ESG) into its investment decisions and is an active owner on your behalf through its voting and engagement activity.

To help us manage your portfolio, please indicate which one of the following options most closely reflects your preferences.

### **Aware (default choice)**

My aim is to optimise financial returns for my risk level, and I acknowledge that being aware of ESG factors is an input to achieve this.

### **Engaged**

My aim is to invest with a focus on ESG factors in order to achieve my financial goals within the agreed risk level

### **Dedicated**

My aim is to invest on a sustainable basis where the consideration of ESG factors drives the investment decisions in my portfolio in line with the agreed risk level

Quilter Cheviot offers clients the ability to screen certain sectors or activities within a portfolio. The nature and extent of these screens will contribute to the determination of your preferences for responsible investment. The implementation of screens may result in the portfolio's performance deviating from the comparable (non-constrained) benchmark. You will need to complete the investment restrictions supplement.



## Examples:

- If a client has expressed a preference for the Engaged category, then we would expect their portfolio to be aligned to that strategy. If they wish to retain existing holdings that are not compatible, for example because of other financial considerations such as tax, then the client would remain within the Aware category. We would discuss this with the client and agree a plan to transition the portfolio to the Engaged category.
- If a client has a specific exclusion (for example, fossil fuels) then this does not automatically move them to a different category. To move into Engaged or Dedicated the portfolio must be aligned with those categories.

Selecting one of the three preference categories (Aware, Engaged and Dedicated) will result in different investment solutions. For some clients it might mean that there is not a strategy that matches their risk profile – for example within the Dedicated category we do not have a lower-medium risk option. For others it might mean that their income requirements cannot be met from just dividends.

Therefore, it is important that the client considers their responsible investment preferences alongside all their other requirements.



# Capturing Responsible Investment Preferences

For advised clients: we recognise that many financial advisers will use their own questionnaires to capture client preferences, and our approach has been designed to avoid conflicting outcomes or confusion for the client. We also believe that to fully understand a client's requirements a conversation is the best approach. That is why we will capture preferences either at the client take on stage or through the regular suitability cycle, unless the client wishes to discuss this sooner.

By having distinct categories, we believe that this will enable our approach to map across to advisers' frameworks without adding another layer of complexity.

For direct clients: the key is the conversation between the investment manager and the client.

It is important that the client understands how we will be managing their investments and therefore we will include their preference information within valuations and the suitability letter.

## Client-driven exclusions

While many clients may want to invest with a positive bias towards sustainable investments or want to use their investments to engage with company managements for change, other clients may want to exclude certain activities or sectors from their portfolio. We continue to use Ethical Screening as our tool to achieve this. This is only possible for certain DPS strategies.

After an initial conversation with the client to help understand their concerns we will follow up to confirm this through a questionnaire. It is important to understand the implications of exclusions and the possible impact on a client's risk/return profile. Having a conversation to understand the areas of concern to them is a far better way to achieve an outcome that pinpoints the areas that they wish to avoid rather than taking a broad-brush approach where every activity might have areas of concern.

### We have two approaches for screening:

**Quilter Cheviot standard questionnaire** - this covers the following areas and for each there are pre-defined exclusions which will cover the majority of client requirements:

- Alcohol
- Animal Testing
- Animal Welfare
- Armaments
- Environment
- Gambling
- Genetics
- High interest lending
- Human Rights
- Nuclear
- Pornography
- Sanctity of Life and Human Embryonic Cloning
- Tobacco

**Quilter Cheviot advanced questionnaire** - this covers more areas and has a number of different screens within them. The additional areas include cannabis, palm oil and fossil fuels.

From April 2022 we will be monitoring all portfolios with ethical exclusions through our risk system. This will enable this to be part of the investment risk team's oversight of portfolios.

# Responsible investment solutions

## Quilter Cheviot's investment solutions

### Active ownership and ESG integration – for all discretionary clients

We vote and engage with companies and fund managers on environmental, social and governance (ESG) matters. Integrating ESG considerations into our investment process can have direct and indirect positive outcomes on the investments we make on behalf of our clients.

**We take a more targeted approach for clients that want their portfolios to reflect their specific interests or preferences.**

### Sustainable Investment – The Climate Assets Funds<sup>4</sup> and Strategy

Through an actively managed multi-asset approach, these are suitable for clients who want to support the development of sustainable societies by focusing on investment opportunities in the areas of Clean Energy, Food, Health & Well-Being, Resource Efficiency, and Water. Ethical exclusions are also applied to avoid investments in controversial sectors.

### A Funds-Based Approach – Positive Change

A pragmatic approach that combines funds that invest with a sustainability focus or for impact, with funds managed by leading responsible investment practitioners. Meaningful engagement by fund houses with company management is prioritised over formal exclusions on the basis that engagement can encourage change where it is needed most.

### A Direct Equity Approach<sup>3</sup> – DPS Applied

The strategies harness Quilter Cheviot's research and responsible investment process, as well as data from external providers, to implement ESG factor screening on a positive and negative basis. This ensures more emphasis is placed on ESG risks beyond the firm-wide approach to active ownership and ESG integration which forms the basis of the Aware categorisation.

### Ethical And Values Oriented Investment – Client Specific

This is incorporated on an individual client basis, informed by their specific ethical preferences and values. These will vary from client to client and will focus on industry groups, industries or individual companies.

### Helping clients choose the most appropriate option

For many clients the Aware option will continue to be the most appropriate – within this the Quilter Cheviot responsible investment approach of ESG integration and stewardship is applied to all our monitored holdings. Additionally, clients will be able to exclude specific areas in line with their own values and ethical preferences within our Discretionary Portfolio Service (DPS).

We believe that each of the categories must be distinct from one another to ensure that there is a clear differentiation between the approaches and that equally we are very clear about the characteristics of the different options available within the three categories.

<sup>3</sup> For UK, North American and European equity holdings

<sup>4</sup> Climate Assets Balanced Fund and Climate Assets Growth Fund.



# What does this look like against the client categories?

We use external data providers and other publicly available data alongside our analysts' and responsible investment team's meetings with companies and fund managers, to undertake our active ownership and ESG integration work.

	Aware	Engaged		Dedicated	
	DPS, MPS, AIM, QCGIG <sup>5</sup> , Libero Balanced	DPS Applied	Positive Change	Climate Assets	Specialist mandates
<b>Type of investments</b>	Depending on the strategy the investments will be via direct and/or indirect (third party funds) holdings across asset classes. AIM is solely invested in equities	A mix of direct and indirect investments across asset classes	All indirect via third party funds across asset classes	A mix of direct and indirect investments across asset classes	This will depend on the nature of the mandate which must be approved by the Chief Investment Officer and reviewed by the Investment Oversight Committee. Holdings within a mandate must meet the threshold of Engaged
<b>ESG focus</b>	Client instructed exclusions where applicable	Positive and negative ESG screening on direct holdings, as well as meeting threshold ESG integration metrics. Funds meet the threshold ESG integration metrics following our fund research team's proprietary framework. There are no formal exclusions for the fund holdings. Several underlying funds apply various negative screening criteria.	Bias towards funds that have a sustainability or impact focus. Funds also held that meet high ESG integration metrics as per our fund research team's proprietary framework. There are no formal exclusions for the fund holdings. Several underlying funds apply various negative screening criteria.	Through an actively managed multi-asset approach, these are suitable for clients who want to support the development of sustainable societies by focusing on investment opportunities in the areas of Clean Energy, Food, Health & Well-Being, Resource Efficiency, and Water. Ethical exclusions are also applied to avoid investments in controversial sectors. The Fund avoids investments where the majority of the revenue is derived directly from the production or distribution of adult content, factory farming, gambling, military, nuclear, tobacco and alcohol	To screen on a negative and positive basis in line with the client policy  Used at a portfolio level for direct holdings to ensure that the portfolio is managed in line with the agreed ethical policy

	Aware	Engaged		Dedicated	
	DPS, MPS, AIM, QCGIG <sup>5</sup> , Libero Balanced	DPS Applied	Positive Change	Climate Assets	Specialist mandates
<b>Stewardship - equities</b>	Direct and listed holdings within the monitored list, as well as holdings in the UK where we own more than £2million or 0.2% of the market cap of the holding, and holdings within MPS and the AIM strategy fall under Quilter Cheviot's active ownership framework where we engage with companies and vote on behalf of our clients	Direct and listed holdings fall under Quilter Cheviot's active ownership framework where we engage with companies and vote on behalf of our clients	The third-party manager funds are a mix of smaller houses with strong sustainability and impact track records, as well as larger investment firms which are regarded as ESG leaders for their active ownership agenda (and which owing to the size of their holdings have significant voting influence on behalf of their clients)	Direct and listed holdings fall under Quilter Cheviot's active ownership framework where we engage with companies and vote on behalf of our clients	Direct and listed holdings fall under Quilter Cheviot's active ownership framework where we engage with companies and vote on behalf of our clients
<b>Stewardship - funds</b>	Funds within the monitored universe fall within Quilter Cheviot's stewardship approach (see columns to the right)	Quilter Cheviot engages with fund managers on their voting, engagement and ESG integration processes as part of the overall fund ESG integration process. Funds are assessed in line with our proprietary framework			
<b>ESG Integration</b>	All holdings within the monitored universe are part of Quilter Cheviot's firmwide ESG integration process	Fund ratings – minimum requirement that all funds will be integrating ESG factors into their investment analysis and decision making even if some work is still in progress.  A qualitative assessment is made for exposures where it remains more difficult to integrate ESG factors such as government bond funds		All holdings are part of Quilter Cheviot's firmwide ESG integration process	All holdings are part of Quilter Cheviot's firmwide ESG integration process
<b>SDG alignment</b>				There are five positive investment themes are at the heart of the stock selection so that at any one time all the following themes are represented in the investments of the fund. These themes are aligned to the UN Sustainable Development Goals (SDG)	

## At a glance

	Aware <sup>6</sup>	DPS Applied	Positive Change	Climate Assets	Specialist
<b>Stewardship</b>	Yes	Yes	Yes	Yes	Yes
<b>ESG Integration</b>	Yes	Yes	Yes	Yes	Yes
<b>ESG Focus</b>	No	Yes	Yes	Yes	Yes
<b>SDG alignment</b>	No	No	No	Yes	No

<sup>5</sup> QCGIG is the Quilter Cheviot Global Income & Growth Fund for Charities

<sup>6</sup> Stewardship and ESG integration only apply to holdings which are within the monitored research universe, or in the case of stewardship where we hold more than £2million or 0.2% of market cap within the UK. All holdings within MPS and AIM are within the stewardship and ESG integration processes.

# Frequently asked questions

## How will we capture client preferences for new clients?

The idea is to start collecting preferences for new clients first in a revised Application Form from early 2022. The investment proposal system will go live with the client categories in mid-February 2022. We will flag this within the quarterly investment summary that is sent to clients in January and April 2022.

## How will we capture client preferences for existing clients?

We will capture preferences through the RSA (regular suitability affirmation) process unless an adviser or client prompts an earlier discussion. We are not sending out a questionnaire direct to clients given the importance of having a conversation. We are planning to treat existing clients as 'Aware' by default, unless they are invested in Climate Assets (Dedicated), or Positive Change (Engaged). We will flag to investment managers those clients who have multiple ethical restrictions as the investment manager may wish to engage with them sooner on this topic to discuss which preference is most appropriate.

For advice and dealing clients; client preferences would be captured at the next point of contact with the client.

## If through the suitability process a client indicates that they wish to move from one category (e.g. Aware) to another (Engaged) how is this managed?

If you establish with the client that their requirements fit into the Engaged category, then this should be discussed with the client to explain the potential implications – for example capital gains tax. Therefore, it may be that the move to the Engaged category takes place over a couple of years and until then the client remains within the Aware category. This is a preference that needs to be weighed up against all the other client requirements.

## Presumably these strategies will become available across the risk spectrum?

We are unlikely to replicate the full suite of strategies – we really have very few Defensive/Conservative lower risks clients and there is limited availability of appropriate funds within the alternatives' exposure.

## What support are you offering advisers?

We will be running webinars for advisers (and investment managers) to explain our process and how this will work.

## Is this a regulatory requirement?

Following Brexit, the UK is outside this regulation, however QCE is within it from June 2022. From our perspective we believe that the UK will introduce similar legislation and there is significant demand from clients and advisers for investment managers to be clearer about the options being offered to the consumer.

Notwithstanding the regulatory backdrop we do believe that this is a positive development for clients as it gives them greater influence on how we invest on their behalf.

## How are we going to treat clients who have existing ethical restrictions?

The majority of clients with ethical restrictions will remain in the Aware category as the nature of the restrictions will not map to the Engaged or Dedicated categories.

Investment managers will be reviewing clients with ethical considerations that have been captured through our standard and advanced questionnaires. It is important that restrictions which may not have been formally recorded are now captured through one of these questionnaires.





## SPECIALISTS IN INVESTMENT MANAGEMENT

**Investors should remember that the value of investments, and the income from them, can go down as well as up. Investors may not recover what they invest. Past performance is no guarantee of future results.**

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