QUILTER CHEVIOT

RESPONSIBLE INVESTMENT

Ethical and Values-Oriented Investment

SPECIALISTS IN INVESTMENT MANAGEMENT

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Ethical and values-oriented investment

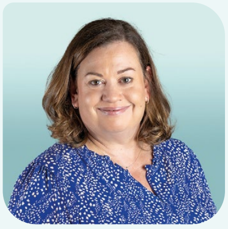
This guide outlines our approach to ethical and values-oriented investment, also known as ESG (environmental, social and governance) screening.

Ethical investment is when we implement a client's specific ethical concerns within their investment portfolio. We use an external screening system to implement ethical policies for our clients.

In this guide we cover:

- What we do at Quilter Cheviot
- What is ethical investment?
- Ethics are personal
- Understanding the context and implications
- Implications for your portfolio and performance
- The screening process

For further information please contact:



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Approaches to responsible investment

We have adopted the Investment Association's Responsible Investment Framework. Within the responsible investment universe there are different approaches; in this guide we are talking about the exclusions approach.

Stewardship	ESG integration	Exclusions	Sustainability focus	Impact investing
The responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society. (Financial Reporting Council)	The systematic and explicit inclusion of material ESG factors into investment analysis and investment decisions. (UN Principles for Responsible Investment)	Excluding entire sectors, activities, companies or countries from a fund or portfolio based on ESG criteria, moral or ethical views, or religious beliefs.	Investment approaches that select and include investments on the basis of their fulfilling certain sustainability criteria and/or delivering on specific and measurable sustainability outcome(s). Investments are chosen on the basis of their economic activity (what they produce/ what services they deliver) and on their business conduct (how they deliver their products and services). (Investment Association)	Impact investments are investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return. (Global Impact Investing Network)
What does this mean? • Ongoing engagement with the companies and funds we invest in to discuss their handling and disclosure of ESG related issues • Engagement may be undertaken individually or in collaboration with other investors • Using voting rights where applicable to further our engagement	**What does this mean?** • It is not about excluding certain activities but it is understanding the ESG related challenges and opportunities • It is about risk mitigation • The approach depending on the asset class	**What does this mean?** • Across Quilter we have a firm-wide restriction on investing in controversial weapons directly or indirectly through actively managed funds • Some of the strategies or products we offer have specific exclusions as part of the investment mandate • Within our DPS offering clients are able to set their own exclusions	**What does this mean?** • Different strategies will set different sustainability outcomes • For many strategies this will be linked to supporting the UN Sustainable Development Goals	**What does this mean?** • Investing in different asset classes to intentionally achieve positive social and environmental outcomes • Lower financial returns may be accepted to achieve social/environmental returns

Based on the Investment Association's Responsible Investment Framework November 2019

What we do at Quilter Cheviot

This guide outlines our approach to ethical and values-oriented investment, also known as ESG (environmental, social and governance) screening.

Responsible investment 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 who would like their portfolios to reflect their specific interests or preferences:

A Direct Equity Approach* – 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 to ensure more emphasis is placed on ESG risks beyond the firmwide approach to active ownership and ESG integration which forms the basis of the Aware categorisation.

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 ESG 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.

Sustainable Investment – The Climate Assets Funds 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.

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.

*For UK, North American and European equity holdings

What is ethical investing?

Exclusions prohibit certain investments from a fund or portfolio. For us these are client-driven at the portfolio level, and at a fund level these are set within the fund's objectives. Ethical or values-based investing is often associated with exclusions, an approach that incorporates an investor's moral principles, values or religious beliefs by screening out investments with particular features. These may be applied on a variety of issues.

If we think about the difference between ethical and ESG integration - ethical investing is a values-driven approach to investing, focused on excluding assets that do not match the personal values of the investor, effectively looking at the impact the assets have on the world around them.

ESG integration, on the other hand, considers the impact that an investee company's environmental, social and governance practices might have on the future financial prospects of the investee company, how the company is managing those factors and how they are priced into the investment.

Charities have legal guidelines they should consider when formulating an ethical policy and for more information, please speak to your investment manager.

Ethics are personal

- There is no such thing as an ethical portfolio that will suit every ethical investor
- Portfolios or unitised funds will be constructed to reflect a specific set of ethical concerns

There are 5 traditional 'sin' sectors: tobacco, arms, gambling, alcohol and pornography.

These are the five sectors which tend to receive the most attention when ethical policies are being discussed. However these areas may not align with every client's objects and concerns.

Ethics are very personal and therefore we do not have a one size fits all approach; instead we work with you to determine the right policy to meet your criteria.

We use an external screening system to implement ethical policies for clients.

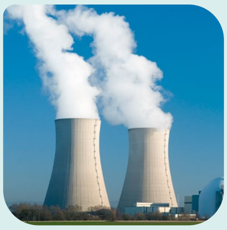
The system covers the following areas:

Ethical issues & social impacts

- Alcohol
- Armaments
- Gambling
- Nuclear
- Pornography
- Tobacco

Human rights, labour & communities

- Human rights – direct impacts
- Supply chains
- Product responsibility
- Sanctity of Life



Environmental impacts & climate change

- Environmental ratings
- Fossil fuels

Animal welfare

- Animal testing
- Animals for food
- Animals non-food

Other issues

- Cannabis
- Consumer credit
- Genetic modification
- Palm oil

Understanding the context and implications

Your investment manager will discuss your ethical concerns with you and will help formulate the ethical policy that meets your requirements. We have two ways in which we approach this:

1

An ethical restrictions supplement which covers the most common ethical concerns

2

A more detailed questionnaire for more complex concerns, which helps to map the appropriate policy for you

We mentioned the classic sin stocks of tobacco, alcohol, armaments, gambling and pornography previously. However even with these, there are different ways to screen these activities.

- **Production versus retail –** if you decide to exclude tobacco and alcohol from your portfolio, we would usually recommend that you exclude the producers rather than the retailers of these products. The rationale is that if we incorporated companies that sold these products we would capture a plethora of companies across a number of different sectors; for example: oil companies would be excluded as they operate petrol stations which sell tobacco and alcohol products, as well as of course, supermarkets. On this basis we would instead look to include companies, such as pubs, which derive a significant proportion of their revenue from the sale of alcohol - see materiality below.
- **Retail of guns –** calibrating the armaments' policy is important, for example some well-known retailers in the US, sell guns. The intention of the armaments' exclusion may well be aimed more at military use so it is important to set the appropriate level of screening.
- **Pornography –** there are very few companies that are picked up in a screen of producers of pornography; however mobile providers may be captured in a distribution screen.

Materiality

It is important to evaluate the materiality of the exposure a company might have to an excluded activity. As part of the screening process we are able to quantify this.

As shown in the above example of production versus retail, understanding the extent of the exposure a company might have to an activity is an important part of the process.

Quilter Cheviot's responsible investment approach includes active ownership and ESG integration. For clients who wish to have an exclusionary or screening approach as well this is how it works.

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- Active ownership agenda: voting & engagement
- ESG integration
- Controversial weapons exclusion

Client-led

- Ability to set screens/ exclusions for direct holdings on a portfolio specific basis
- Suitable for portfolios investing directly in equities
- Data relating to the screens is provided by Ethical Screening (our external research provider)

Implementation

- For direct holdings only
- Agree screens and understand the implications for the portfolio
- Screens are linked to our dealing system to ensure compliance

You may wish to exclude exposure to fur; this is defined as excluding companies which are involved in:

- Breeding and rearing of animals for their fur (or skin);
- Trapping and other means of taking animals from the wild;
- Retailing of fur (or skin) products, including clothing or shoes with fur trim or detailing.

This has the potentially unintended consequence of excluding companies such as Amazon. In the case of Amazon, it is captured within this exclusion as it facilitates the sale via its intermediary role between sellers and customers. The sale of fur from endangered or threatened species is not permitted.

It may be that you wish to exclude these secondary markets; however it may be that the focus was more on primary sellers of fur. Therefore being able to understand the reason why a company is excluded under your policy is a very useful tool.

TIP – what are you excluding?

The more complex ethical screens become, the more important it is to understand why certain companies are excluded so you remain informed of the implications of the policy.

In order to help our clients understand why certain companies are being excluded we are able to provide you with a report including the rationale for exclusions.

Implications for your portfolio and performance

Portfolio construction will be impacted by a complex ethical policy or even one which focuses on only a few specific sectors or industries.

FOR EXAMPLE: If your ethical screens exclude more than 20% of the investment universe it is likely that the portfolio's performance will deviate (at times) significantly from the comparable (non-constrained) benchmark.

Benchmark

Screened indices i.e. those that screen out certain activities are sometimes recommended as useful comparators for ethical portfolios. However these rarely match a client's specific ethical concerns and therefore should be approached with some caution.

As an example, the MSCI ESG Screened indices exclude companies with the following exposure:

- controversial, civilian or nuclear weapons
- tobacco
- thermal coal
- oil sands extraction
- that are not in compliance with the United Nations Global Compact (UNGC) principles

Given the potential mismatch between a client's ethical policy and that of a screened index we use the MSCI PIMFA Indices, the ARC (Asset Risk Consultants) peer group indices for private clients and charities, as well as composites of market indices as performance comparators.

However, it should be noted that these are not adjusted for any ethical exclusions and therefore at certain points in time, depending on your ethical policy, there may be significant differential between the benchmark or peer group return, and the portfolio's return.

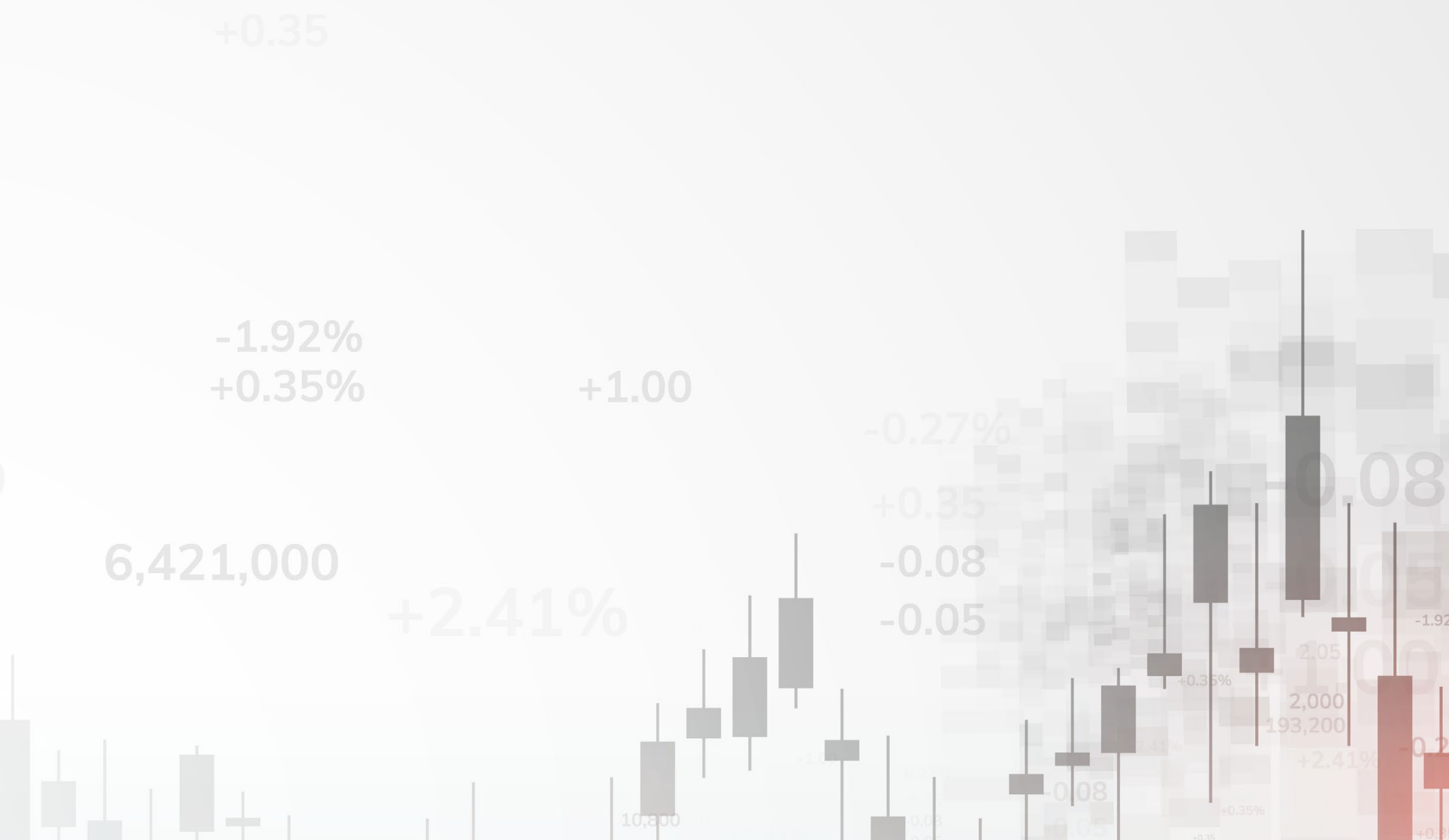
Performance

The issue of whether the investment performance of ethical mandates is worse than 'unethical' portfolios is complex. It will depend on a number of different factors including:

- What is the ethical policy?
- How much of the investment universe does the policy rule out?
- Does the policy result in there being a concentration on specific sectors and zero weighting in others?
- What replaces the excluded companies? It is not just about what you don't invest in, but also what you do

In order to assess clearly the impact of an ethical policy on performance then we would recommend considering the following:

- Over a period of time i.e. three or five years – market cyclicality will mean that at different times the ethical policy may help or hinder performance depending on what the policy excludes
- The 'ethical' portfolio should be compared to a similar portfolio managed by the same investment manager which does not have an ethical policy. It is then much easier to determine whether it is the ethics or not impacting performance (negatively or positively).



Risk

Depending on the extent and remit of the ethical policy you may inadvertently change your risk profile. This will depend on a number of factors:

- How much of the market are you excluding?
- How much of the investment manager's core investment universe is impacted?
- Is there a particular bias within the policy to specific sectors? For example excluding tobacco, alcohol and animal testing for cosmetic purposes leads to a significant proportion of the consumer sector being excluded
- Is the activity you wish to exclude a significant part of the index? For example the UK market has a significant weighing in oil & gas; most investors who have concerns about fossil fuels tend to exclude those which are engaged in specific activities such as tar sands or thermal coal rather than excluding the entire sector

We work with our clients in understanding the potential impact an ethical policy might have on risk adjusted returns.

The screening process

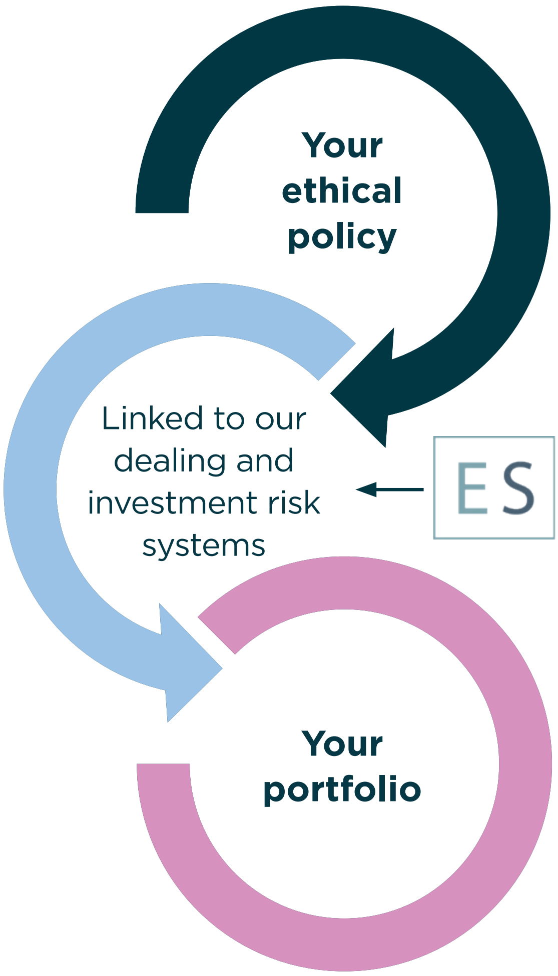
We use Ethical Screening, an external research firm which was established in 1998 to provide research and analysis identifying corporate activities which may concern an investor who wishes to set an ethical policy. Ethical Screening gathers the information from a range of sources to build a picture of the company and its activities, additionally it engages directly with companies.

At the same time we utilise the knowledge of our investment managers and research analysts to understand the ethical issues that specific companies may present for investors.

When we have defined your policy, we link this to our dealing and investment risk systems to ensure that the portfolio is managed in line with your ethical concerns on an ongoing basis.

We are able to screen direct holdings through this system. When we invest via funds we cannot guarantee that third party funds will be managed in line with your ethical policy unless the fund has specific exclusions within its objectives.

Our fund research team evaluates how third party managers incorporate environmental, social and governance (ESG) factors into their investment process, alongside traditional financial metrics, as well as the manager's approach to voting & engagement (stewardship).



Conclusion

Ethical decisions are client-led and we work with each client to implement their policy to ensure that it meets their specific concerns.

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This is a marketing communication. The value of investments, and the income from them, can go down as well as up and past performance is no guarantee of future returns. Investors may not receive back the amount originally invested. Investments and investment services referred to may not be suitable for all recipients.

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