# Selecting ethical or sustainable investment funds

*Dr Quintin Rayer*
*DPhil, FInstP, Chartered FCSI, SIPC, Chartered Wealth Manager*
*Head of Research and Ethical Investing at P1 Investment Management*

**Biography**

Quintin has worked for actuarial and investment consultancy firms and a multi-national European bank, including wide experience in quantitative fund and risk analysis. He is a Fellow of the Institute of Physics, a Chartered Fellow of the CISI and a Chartered Wealth Manager. Quintin has applied skills gained from his Oxford University Physics Doctorate and while working in engineering to finance. He is the second UK graduate from the Sustainable Investment Professional Certification (SIPC) programme and joined P1 Investment Management in January 2017, founding their ethical and sustainable investing proposition.

**Introduction**

Previous articles asked why ethical investment matters [1], introduced sustainable (environmental, social and governance, or ESG) investing [2]; and looked at some different approaches [3], [4]. As a change of perspective, this article considers the selection of ethical funds, outlining some of the challenges that investors face. Future articles intend to explore topics such as performance.

Beyond the usual portfolio construction considerations, ethical investors must select companies and monitor their performance in ethical and sustainability terms. Whichever approach is used, environmental issues, social responsibility and governance quality are not readily measurable. Consequently, many investors employ the skills of specialist fund managers. This, in turn, raises questions as to how investors can be sure that the fund managers they select are genuinely investing as their clients would wish. Investors wish to be confident that the managers they choose have robust ethical and sustainable investment policies, rather than using a green gloss to obtain a marketing advantage.

**Ethical funds**

Many fund management houses run ethical strategies, with more being offered as the approach gains popularity. While some managers are specialists, others include ethically orientated funds as part of their broader offering.

A concern for investors is whether fund managers lack ethical investing experience or commitment, but want to ‘jump on the bandwagon’, launching a fund to appeal to the ethical market. Although promoted as such, a fund’s ethical credentials may be slender, potentially including holdings that would make clients uncomfortable. Some funds may only underweight investments in undesirable areas rather than avoid them altogether. Others may focus on engaging with company boards, rather than restricting their investments.

Providers may launch new ethical funds but fail to reach required asset targets to make them commercially viable. Insufficient investment in resources or appropriate staff could result in an inability to deliver the performance expected, with a gradual erosion of interest. Consequences could include a merger with a conventional fund, closure, or dropping ethical objectives.

Fund selection should explore how deeply embedded ethical investing culture is in the organisation. Managers may find clients like to hear them talk positively about ethical investing, doing so for marketing benefits. Examining staff experience and qualifications can help detect superficial commitment since only serious providers are likely to have invested in individuals with proven knowledge and skills.

**Portfolio construction**

It is useful to appreciate the challenges facing managers constructing ethical portfolios. When considering a company for inclusion, apart from return, risk and diversification aspects, ethical requirements must be considered. Although some criteria are straightforward, others can be more complex.

Managers are assisted by corporate standards, covering diverse areas. Many are voluntary, confirming that specified activities have been conducted to a defined quality. The sheer number of different standards can be challenging, and requirements vary. However, some standards provide more symbolic than real value [5]. Initiatives motivating companies to behave more responsibly include auditable quasi-official standards, initiatives encouraging companies to report emissions, achievements and progress to stimulate improvement; but may also be purely aspirational.

Companies’ annual reports and accounts can reveal ethical, sustainability, social, environmental objectives and standards, as well as information about corporate governance [6]. Governance can explore the nature and composition of the board. This can include the roles of NEDs, turnover, expertise, independence, diversity, ability to challenge executives, the remuneration committee and level of shareholder engagement.

For those fund managers that engage with company boards, the quality of their engagement can be challenging to assess, as well as their commitment to persistently follow up on areas of concern. As shareholders, many use proxy voting, but not all have a defined voting policy, and fewer ask questions at shareholder meetings or file shareholder resolutions. Fund managers with stronger engagement practices will discuss their decisions pre and post voting. At one extreme, some will propose policies to link director remuneration to issues of concern. In contrast, others will outsource voting to external commercial providers. All would claim they use engagement to meet

ethical goals, while the quality and commitment vary considerably.

Investors must dig beneath ostensible statements regarding achievements, since many companies desire a ‘green makeover’, but may be reluctant to absorb the costs and challenges required for genuine change [7]. The complexity means that investors may benefit from support by wealth managers knowledgeable in this area.

**How this helps Investors**

By appreciating the challenges ethical fund managers face, individuals who wish to invest ethically should be better placed to understand the strengths and weaknesses of products offered. It can be difficult to assess the fund managers’ commitment and the robustness of their ethical investment policies. A better appreciation of what is involved should help them choose an approach or provider that meets their needs.

**References**

[1]
Q. G. Rayer, "Introducing Ethical Investing," The Private Investor, the newsletter of the UK Shareholders' Association, no. 199, pp. 12-13, April 2019.

[2]
Q. G. Rayer, "Introducing sustainable "ESG" investing," The Private Investor, the newsletter of the UK Shareholders' Association, no. 200, pp. 10-11, June 2019.

[3]
Q. G. Rayer, "Ethical investing approaches: screening and best-in-class," The Private Investor, the newsletter of the UK Shareholders' Association, no. 202, pp. 8-10, 18 October 2019.

[4]
Q. G. Rayer, "Ethical investing: portfolio tilting and corporate engagement," The Private Investor, the newsletter of the UK Shareholders' Association, no. 203, pp. 12-13, 23 December 2019.

[5]
P. Shrivastava and S. Berger, "Sustainability Principles: A review and directions," Organization and Management Journal, vol. 7, no. 4, pp. 246-261, 2010.

[6]
R. Monks and N. Minow, Corporate governance, Oxford, England: Blackwell Publishing,, 2011.

[7]
C. Krosinsky, N. Robins and S. Viederman, Evolutions in sustainable investing: strategies, funds and thought leadership, John Wiley & Sons, 2012.

This article may be cited as: Q G Rayer (2020), Selecting ethical or sustainable investment funds, The Private Investor, the newsletter of the UK Shareholders' Association, issue 204, February, p10-11, 18th February 2020.

# Inheritance tax – More ideas!

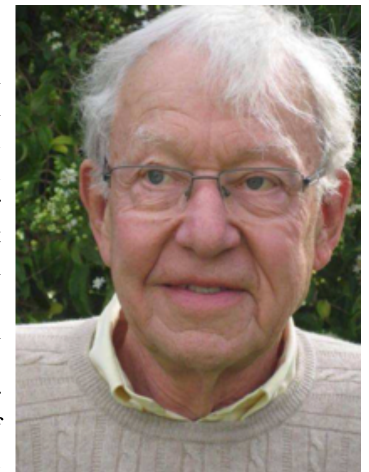
*by Roy Colbran*

Hot on the heels of the report from the OTS for simplifying the IHT regime we now have proposals for a far more drastic review. These come from the All-Party Group on Inheritance and Intergenerational Fairness set up by the Chairman, John Stevenson MP, to consider the subject. At the time of publication the Group had as Officers two Conservative and two Labour MPs.

Newspaper headlines on publication concentrated on the suggested reduction in the tax rate from 40% to 10% leading to the natural thought that the Treasury would never wear that. However, closer examination of the report shows that there are plenty of places where the tax take would increase to compensate.

The evidence base that the Group drew upon was much narrower than that used by the OTS. Possibly that does not matter since the proposals are so radical that there is no need for details of the problems that the present system causes. Moreover they had the benefit of the OTS report in front of them and the support of the Society of Trust and Estate Practitioners, who must have loads of experience.

The main proposal is that there shall be immediate tax at the same rate on both lifetime and death gifts. For lifetime gifts there would be an annual tax-free allowance; the Group suggests this should be as much as £30,000, but the value of all gifts in excess of this level would attract a tax of 10% payable by the donor. For non-liquid assets there would be an option to pay over 10 years subject to interest. There would be a death allowance, transferable between couples as at present, at a level something like the current Nil Rate Band but no equivalent for lifetime gifts. The great advantage of this system would be that it would do away with the need for all the complicated reliefs that apply at the moment. These include the seven-year rule, normal expenditure relief and tapering as well as the special residence nil-rate band. Agricultural and business allowances would disappear as would reservation of benefit rules and so, overall, the system would become much simpler and more understandable.



Discretionary trusts would still be possible with gifts into the trusts taxable in the same way as for individuals. There would then be an annual tax based on the value of the assets in the trust and the Group mentions the possibility of further tax on distributions, although that feels like double taxation to me.