What is ‘Tilting’ and ‘Influence and Engagement’ in sustainable investing?

By Quintin Rayer | Nov 20, 2017

Previously, Quintin Rayer asked why ethical investment matters, introduced sustainable (environmental, social and governance, or ESG) investing , and looked at the ‘screening’ and ‘best-in-class’ approaches to ethical investing. This article looks at different approaches for achieving ethical investment goals, exploring ‘tilting’ and ‘influence and engagement’. Future articles will explore topics including performance.

Introduction

Ethical investors selectively allocate resources to deserving areas while avoiding unacceptable businesses. Sectors of concern often include alcohol, tobacco, gambling, pornography, armaments and nuclear power, or other areas [1]. Investors may avoid these altogether, or underweight them in portfolios.

Investors may consider whether to
» Avoid unethical companies, but accept companies doing neither good nor harm?
» Invest only in ethical companies, avoiding both the unethical and those that do neither good nor harm?
» Actively seek to influence corporate behaviours for the better?

These questions help identify different approaches.

Investment Approaches

Sustainability can help determine whether activities should be seen as having positive or negative impacts, based on ESG factors. Screening is commonly used, but other approaches include 'best-in-class', 'tilting', or 'influence and engagement'. Screening and best-in-class have been discussed previously, the focus here is on 'tilting' and 'influence and engagement'.

For companies in ethically-challenging sectors screening may not be effective at discouraging harmful behaviours. Consider an imaginary mining company against different ethical investing strategies. Suppose it has a poor record regarding environmental damage, pollution, treatment of labour and indigenous peoples. Screening would exclude the company based on sector, which would likely be unacceptable. Management can do nothing to make the company acceptable, apart, presumably, from winding its operations up.

However, the company could be influenced by approaches such as 'tilting', 'influence and engagement' or shareholder activism. Considering 'tilting', for example, the company could reduce carbon-emissions, becoming more attractive than peers to investors focused on climate change issues.

Portfolio Tilting

Providers can supply data on businesses' ESG ratings or carbon-emissions. Perhaps determining whether a portfolio is over or under-weight its benchmark in terms of carbon-intensity.

In this graduated approach, a portfolio is tilted away from carbon-intensive sectors or companies towards lower carbon areas. For investors fearing that ethical investing might undermine performance, this offers a 'light green' approach. Exposure to carbon-intensive areas is permitted, provided that elsewhere, sufficient weight is given to low-carbon industries, and overall the portfolio has a lower carbon-intensity than its benchmark index. The manager can allocate across many companies or sectors helping with diversification.

Another practical implementation of tilting applies to the overall portfolio profile. For a client concerned that ethical funds may underperform, the majority of their portfolio can be invested conventionally (allaying underperformance fears), and the remainder ethically. Perhaps investing 80% conventionally and 20% ethically. As the client acclimatises to ethical investment, the conventional proportion can be reduced.

Influence and Engagement

This approach involves influencing company directors to make improvements in matters of ethical concern [1]. Directors are encouraged and supported to improve the balance between risk and return in the best interests of long-term owners.

The process may involve management meetings, questionnaires, and collaboration with other fund managers. The intention is to influence companies to consider their responsibilities to the environment, their stakeholders, which may include, for example, staff, customers, shareholders and those living near their centres of operation, and society as a whole.

How this helps Advisers

Clients increasingly want ethical considerations taken into account, with evidence that younger people see this as a higher priority than older generations. Apparently, twice as many 18 to 34-year-olds with pensions felt they should be invested ethically, compared with those above 45 [2]. The Investment Association reports £14.4 billion assets in the UK ethical funds sector in August 2017, a yearly increase of £4.3 billion [3].

Naturally, this makes it important for advisers to be able to support their clients by appreciating key ethical approaches in this growing area.

References

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

[2] BBC, "More young savers 'want ethical pensions'," 8 October 2017. [Online]. [Accessed 10 September 2017].

[3] "PDF ARCHIVE OF STATISTICS," The Investment Association, August 2017. [Online]. [Accessed 1 November 2017].

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