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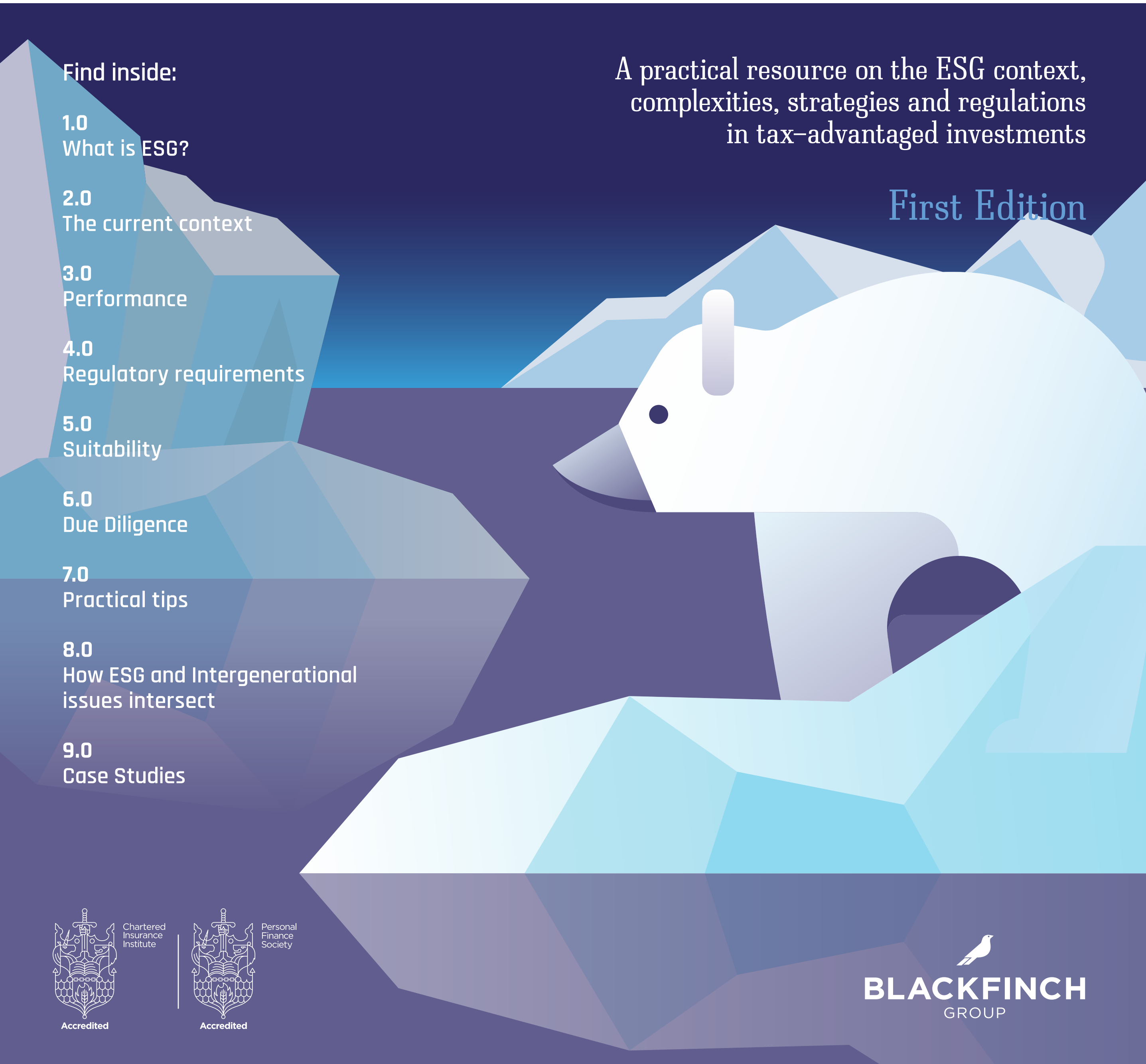
An Adviser's Guide to Environmental, Social & Governance: Tax advantaged investments



A practical resource on the ESG context, complexities, strategies and regulations in tax-advantaged investments

First Edition

Find inside:

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An Adviser's Guide to

Environmental, Social & Governance:

Tax advantaged investments

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Introduction

Welcome to the first edition of An Adviser's Guide to ESG: Tax advantaged investments. With the rapid escalation of climate change imperatives, the FCA's spotlight on culture within firms in recent years, and the advent of Covid-19 driving community mindedness and social awareness, Environmental, Social and Governance (ESG) issues have been pushed very much to the forefront in financial services. For financial advisers, this is a very wide-ranging and potentially complex area, involving not just their actions and outcomes for clients, but their corporate values and contributions to society.

This guide aims to give an overview of what advisers should know about ESG as it stands, including the technical and practical aspects, drawing a focus to tax-advantaged investments, including the Enterprise Investment Scheme, Seed Enterprise Investment Scheme, Venture Capital Trusts and Business Relief, and what it means for them.

GUY TOLHURST

MANAGING DIRECTOR, INTELLIGENT PARTNERSHIP

Acknowledgements

A guide like this is rarely the product of one organisation's efforts: to ensure that it is up to date, comprehensive, accurate and captures all of the key issues requires an industry-wide initiative. We've had plenty of help producing this guide and would like to thank Neil Pearson of Mills and Reeve, Whitni Thomas of Triodos Bank, Henry Philipson of ESG_VC, Julia Dreblow of SRI Services, Mark O'Donnell of MICAP, Gillian Roche-Saunders of Adempi Compliance Consultants, Nick Britton of the Association of Investment Companies, Mark Brownridge of the Enterprise Investment Scheme Association, Alex Sumner of Blackfinch Investments, Henry Whorwood of Beauhurst, and John Featherby of Shoremount. Their input is invaluable, but needless to say any errors and omissions are ours.

Most of all, we would like to thank our sponsor Blackfinch Investments. It would not be possible to produce educational material like this without their generous support and contribution towards production, and distribution.

Learning Objectives

After reading this guide, advisers will be able to:

- Explain what ESG encompasses and how it specifically relates to tax-advantaged investements
- Describe the main drivers for the development of ESG concerns in financial services
- Identify how current and potential ESG-related regulatory requirements may or may not apply in the tax-advantaged investments universe
- Define how ESG and intergenerational issues intersect
- Determine the ESG investment strategies that match the clients' ESG objectives

After you have reviewed this publication and before we fulfill your CPD certification request, we will be requesting your feedback on it. Your collaboration will assist us to enhance the learning activity, and will inform improvements to future publications. Information about claiming CPD can be found at the back of this guide.

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RICHARD COOK

CEO, BLACKFINCH GROUP

Opening Statement

Environmental, social and governance (ESG) issues are often emotive and complicated, and investment trends can be fast paced. While ESG investing has been around in some form for decades, the recent pace of change has been remarkable. It has taken place against a backdrop of a public health crisis, disturbing reports of a global climate emergency, critical levels of plastics in our oceans, and demonstrations against inequality. This is reflected in the growth in public awareness in sustainable lifestyles and social justice causes driven by high profile individuals, organisations and social media campaigns. Some advisers may be tiring of ESG, but I believe they are in the minority – there is no doubt in my mind that ESG is not an investment fad. Therefore, at Blackfinch we will continue to do whatever we can to help educate both advisers and their clients on the long-term value and impact that purposeful ESG investing can deliver.

Much of 2021 was focused on the lead up to the 26th Conference of the Parties (COP26) in Glasgow in November. Although COP26 emphasised a number of coordinated approaches to meet the global challenge of climate change, the finance sector frequently held centre stage. Specific initiatives were announced, including stronger reporting standards, proposals to disclose plans on transitioning to net zero, and several climate investment programmes. I anticipate those initiatives will take further shape this year, but it is already clear that the financial sector can play a pivotal role in transitioning to a more sustainable future, transparently and collaboratively.

One further theme to emerge from COP26 was that the climate emergency can no longer be viewed in isolation. It is intrinsically linked to biodiversity loss and the need to protect forests and sustainable land use, but also carries severe consequences for water consumption and threatens communities. At Blackfinch, we recognise that environmental issues are often interconnected, and that the E, S and the G should never be viewed in isolation. We see this in our own research on an almost daily basis. A company's poor safety record can be a precursor to environmental incidents, consequent fines and damage to its community relations and its reputation. ESG is complicated, which is why we are continuously strengthening our approach and partnering with other organisations to find common ground. In 2020, Blackfinch became a signatory to the Principles for Responsible Investment (PRI). We see this as a public demonstration of our pledge to responsible investment, and it places us within a global community committed to building a more sustainable financial system.

ESG matters are clearly high on the regulatory agenda, and we will be watching with interest how the FCA's recently announced ESG strategy develops in 2022 and beyond. The FCA also recognises that companies and consumers are looking beyond climate change, towards the need for a 'just transition' which considers the social consequences of the shift to a net zero economy. We have to ensure that the decisions taken to support climate action support a fully inclusive economy that avoids worsening existing injustices or creating new ones. This is why we believe climate action cannot be successful without adopting a comprehensive ESG-led approach.

In a world that must adapt to build a more sustainable long-term future, the financial sector has a huge role to play. We are all facing a huge challenge, but it is one that I and everyone at Blackfinch are proud to meet.

What is ESG?

1.1

It's not just the 'E'

Given the quite rightly headline-hijacking climate change issues, with world summit COP26, the alarming scientific projections and flurry of regulatory papers, there has been a strong focus on the ‘Environmental’ aspects of ESG. But ‘Social’ and ‘Governance’ are not to be ignored in the efforts to reshape the economy for the long-term future.

In its November 2021 publication, “A strategy for positive change: our ESG priorities”, the FCA puts it like this, “ESG captures the key dimensions of wider sustainability; that is, how people, planet, prosperity and purpose come together to help enable 'the needs of the present [to be met] without compromising the ability of future generations to meet their own needs.”

The regulator has already committed to building resources and capabilities on ESG beyond climate change, and ensuring that its regulation takes a broader ESG perspective. There are plenty of indicators of where its current and future direction of travel lies outside the ‘E’, including the particular attention paid to diversity and inclusion, with its social power to level up and create positive outcomes in risk management, good conduct, healthy working cultures, and innovation.

The ‘S’ in ESG encompasses an increasingly wide scope of topics, though, with others including human rights, labour issues, occupational health and safety, product safety and quality, bribery and corruption, data privacy and security, and access to medicines and nutrition.

Governance, in terms of the framework of responsibility that oversees the operations and integrity of a firm, and culture, the habitual behaviours and mindsets that sets the tone for everything a company and its employees do, has been high on the FCA’s agenda for a number of years.

In fact, the regulator has referred to a firm’s own governance and culture as, “critical drivers and enablers of its performance on environmental and climate matters. And on its ability to drive positive change, for the benefit of its shareholders, clients and consumers, employees, and wider society.”[1]

Example ESG Issues

Enviromental

- climate change
- resource depletion
- waste
- pollution
- deforestation

Social

- human rights
- modern slavery
- child labour
- working conditions
- employee relations

Governance

- bribery corruption
- executive pay
- board diversity and structure
- political lobbying and donations
- tax strategy

SOURCE: UNPRI

1.2

It's not just a fad

ESG investing can be traced back decades with its roots in socially responsible investing aiming for a broader goal than just financial returns. This involved the exclusion of shares or entire industries from portfolios based on objectionable business activities such as involvement in the South African apartheid regime, or the specific targeting of other socially valuable activities like affordable housing and health facilities. The term "ESG" was coined in 2004 and, while taking this approach was once an exception, it's now becoming the norm[2].

According to the FCA's 2020 Financial Lives Survey, published in February 2021, almost two thirds of participants reported that they worry about the state of the world and feel personally responsible for making a difference. Four out of 5 respondents consider environmental issues important and believe that businesses have a wider responsibility than simply to make a profit, while 70% of the UK public want their money to go towards making a positive difference to people or planet.

Institutions have been serious about these concerns for some time, taking the lead in areas of future impact on their financial returns that intersect with issues that may not traditionally have been considered. Funded pensions were among the first institutions to respond to sustainability concerns. As investors in long-term, widely diversified holdings throughout the global economy, they must manage total market exposure, for example recognizing that environmental and social costs are unavoidable since they affect the portfolio through insurance premiums, taxes, inflated input prices, unrest and instability, which in turn create costs that reduce returns for some investments. One of the foremost examples is environmental degradation, but many other issues such as poverty also loom large.

Governance comes into play in that, where it is poorly applied, it can lead to short-termism, insufficient attention to pertinent environmental and social issues and suboptimal decisions that reduce long-term performance[3].

> ***environmental, social and governance considerations are increasingly important decision-making criteria for many kinds of organisations – not only as a means of winning the trust of stakeholders but also as barometers of effective business management.***
>
> **INSTITUTE OF DIRECTORS POLICY PAPER**
> **ESG PRIORITIES FOR UK COMPANIES, JANUARY 2022**

Government ambition and policy direction, including its legislative commitment to a net zero economy by 2050 and new regulatory disclosure requirements from financial services firms, has cemented the drivers. Meanwhile, Covid-19 has highlighted not only how the well-being of individuals is linked locally, internationally and globally, but also just how quickly real change can be achieved.

This has all fed into investment inflows with data from Refinitiv Lipper to the end of November 2021 showing a record $649 billion poured into ESG-focused funds worldwide, up from the $542 billion and $285 billion that flowed into these funds in 2020 and 2019, respectively. And it's not just in mainstream funds that demand is being felt.

The demand is not going away: Research suggests that ESG assets are on course to exceed $50 trillion by 2025, representing more than a third of the projected $140.5 trillion in total global assets under management[4].

In short, the development of ESG concerns is a massive and ongoing global movement to which the sustainability of not just the planet, but of current business and investment models, is inextricably linked.

Don't be a laggard: ESG adoption timeline

2000-2006
Innovators
small number of pioneers test new methods and ideas in high-risk enviroment

2007-2015
Visionaries
Early adopters embrace new methods based on shared vision and intuition

2016-2019
Pragmatists
Early majority enter sector, beginning of scale and institutional credibility

2020-2025
Conservatives
Late majority adopt tools to catch-up with majority that already use them

2025+
Laggards
Paradigm shift in capital market thinking from 2D to 3D: risk, return and impact

SOURCE: THE RISE OF THE IMPACT: FIVE STEPS TOWARDS AN INCLUSIVE AND SUSTAINABLE ECONOMY, UK NATIONAL ADVISORY BOARD 2017

1.3

It's not a choice for advisers

ESG is not something that financial advisers can simply opt out of.

Advisers are already required to obtain the necessary information from the client, including their investment objectives, to be able to make a suitable recommendation. More and more frequently, the client now has goals beyond the purely financial and a desire that their assets are being put to work accordingly.

Moreover, the regulator has already confirmed that it is working on sustainability-related requirements for financial advisers,[5] with the aim of ensuring advisers take sustainability matters into account in their investment advice and understand investors' sustainability preferences to ensure suitability of advice. In the meantime, MiFID II has already pushed advisers to incorporate questions on an investor's environmental, social and governance goals into the fact find and the government and regulators expect advisers to meet established voluntary standards. (See the Regulatory requirements section of this guide for more information, including what advisers should be doing now.)

There are, of course, plenty of commercial risks and opportunities associated with ESG for financial advisers, all driving the need for involvement sooner rather than later. But more than that, there is also recognition that financial advice is a crucial driver to net zero:

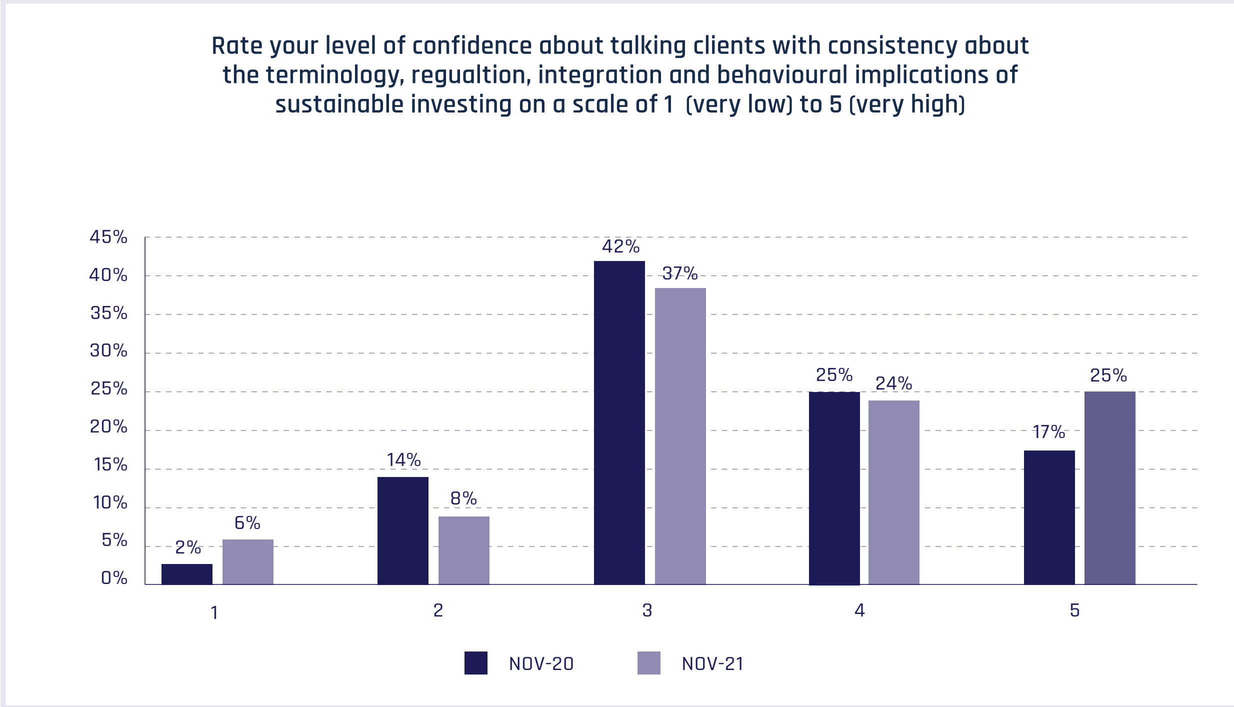
The FCA's Climate Change Adaptation Report of October 2021 states that,

Providers of financial services sit at a unique junction between the real economy and investment ideas. The investments affect the characteristics and performance of the real economy in the future, further influencing society and the environment.

Since a large portion of the cost of reaching net zero is expected to be met by real economy investment, the importance of the role of financial advisers is hard to underestimate: The necessary projected real world investment amount is forecast to climb steadily over the next decade, reaching a required level of £40–50 billion per annum from 2030. This shift comprises approximately 10-15% of current economy-wide investment (of c. £400bn per year).

Advisers, though, may be feeling the pressure, as confidence in this area and recommending investments in it, is low.

According to Schroders' November 2021 adviser survey, over half of advisers surveyed said their confidence was average or low. Perhaps as a result, and despite the prominence of environmental concerns and COP26 in 2021, consideration of ESG factors in fund selection increased only marginally.



SOURCE: SCHRODERS ADVISER SURVEY, NOVEMBER 2021

1.4

It's not just for large funds or institutions

There is a large market for alternative and less mainstream investments that have some ESG focus, including private equity. Today, almost a third of public market capital is committed to ESG and impact investments, and a similar development is now taking place in the private markets[6].

This includes Enterprise Investment Scheme (EIS), Seed Enterprise Investment Scheme (SEIS), Venture Capital Trusts (VCT) and Business Relief (BR) offers, where entry levels can be as low as £1,000. The result is that sustainable investing is well within the reach of a significant cohort of retail investors.

1.5

Investment approaches

There is a range of methods by which investment managers can implement their ESG strategies. These have been described as the building blocks of ESG investment and it is not unusual for investment products to combine a variety of these methods. They include:

Ethical investing

This is a simple approach that aims to avoid, or exclude certain investments to align with client expectations linked to their personal values. The exclusion can be very specific and/or very broad, from particular companies or products, to specific sectors, countries or sectors. So, for example, oil mining as an activity, South Africa as a country or Boohoo as a company. Each has had its own social or environmental issues and could be perceived as unethical.

Also known as negative screening, it is now more usual for these types of funds to also employ positive screening to actively include companies making a positive impact. This is also known as 'best in class' where selection is based on positive ethical investing performance relative to industry peers.

Sustainable investing

Unlike pure ethical investing, sustainable investing looks to specifically and exclusively invest based on sustainability criteria such as climate change mitigation or pollution prevention. It works on the reverse premise of ethical investing since investments are positively screened.

The aim is that companies should be better placed to do well in years to come because they are adapting their businesses for the future. This should mean they deliver sustainable, long-term returns for investors. Nevertheless, this could involve the inclusion of sectors that might never be included in an investment managed on the basis of ethical investing because they have sustainable activities that will de-risk the less ESG-friendly ones in the longer term: Think of an oil company which also uses renewable energy and battery technology[7].

Impact investing

"Investing for impact is one of the best ways we can work together to shape the world we all want to live in and invest in the future of the planet," says Adam Robbins, senior investor relationship manager at Triodos Bank UK. That's because it is about making a real difference, the intention of allocating funds with the intention of generating a measurable positive social, economic or environmental impact, and generating a positive financial return.

It's this quest for a financial return that distinguishes impact investments from philanthropy and the intentionality beyond that which differentiates them from other strategies such as ESG investing, Responsible Investing, and screening strategies. The Impact Management Project has identified the following three 'impact goals' that reflect the intentions of individual investors:

- Avoid harm
- Benefit all stakeholders
- Contribute to solutions

ESG integration

The government publication, Greening Finance: A Roadmap to Sustainable Investing, describes ESG integration as, "the systematic and explicit inclusion of material ESG factors into investment analysis and investment decisions. ESG Integration alone does not prohibit any investments. Such strategies could invest in any business, sector or geography as long as the ESG risks of such investments are identified and taken into account."

They are taken into account because these risks can have a material impact on the performance of investee companies.

Just remember that combining various approaches often happens, so it can be perfectly acceptable for an impact fund to also be sustainable or ethical at the same time, because it can screen out or in certain companies.

Thematic investing

The UN Principles for Responsible Investment (UNPRI) describes themed investing as a strategy that, "allows investors to address ESG issues by investing in specific solutions to them, such as renewable energy, waste and water management, sustainable forestry and agriculture, health products and inclusive finance."

Rather than allocation based on asset class, geography and business sector, these investments capitalise on opportunities created by macroeconomic, geopolitical and technological trends. These are not short-term swings – but long term, structural, transformative shifts[8].

Thought Leadership

IS NEGATIVE SCREENING DAMAGING FOR ESG?

ALEX SUMNER

INVESTMENT DIRECTOR, BLACKFINCH

The recent 'boom' in environmental, social and governance (ESG) portfolios has increased awareness of ESG factors, but it's important to consider the consequences of different screening approaches.

Negative screening is the most common approach by fund managers and discretionary fund managers (DFMs), but does it always do good? Advisers keen to address investor concerns over ESG may ask questions like "what do you object to?" or "which industries do you wish to avoid?" and then select an investment solution that negatively screens out these areas. The downside of this approach is this it can adversely affect both the client's investment and ESG outcomes in the long term.

Many investors consider fossil fuels as environmentally unsound, and therefore expect it to be screened out of their portfolio. However, fossil fuels remain a necessary global resource that cannot be ignored. While some oil companies are focused on drilling for oil and investing in the associated infrastructure, others are directing greater proportions of capital towards greener areas of industry, such as renewable energy.

Mining is another example. For net zero carbon emissions targets to be achieved, vast quantities of lithium and copper required for electric cars must be mined. Some mining companies are improving staff working conditions, (often responding to shareholder voting and pressure) and reducing their negative environmental impact by sourcing alternative minerals which are aiding the transition to greener energy storage.

Divesting from all mining companies risks cutting off the capital they need to help deliver on broader net zero emissions targets, and arguably makes them less likely to improve working conditions, or reduce the environmental impact of extraction methods. Privately run companies face very limited accountability, and therefore are under no real pressure to change.

We strongly feel investors should stay invested in areas of industry where they (or the relevant fund manager) can impact the way such businesses are run. More forward-thinking companies are looking to eventually pivot into greener industries. They should also remain highly relevant and attractive from an investment perspective. Those who stay invested in these companies will hold far greater sway in terms of voting rights and positive ESG outcomes.

Moreover, a positive screening process can unearth and support forward-thinking companies focused on future improvements to ESG factors, and promote greater investment from responsible fund managers who actively engage and monitor their ESG targets.

By negatively screening out great swathes of industry, divestment diminishes shareholder power, potentially reducing positive ESG outcomes in the future. Plus, investors can miss out on some real gems. It is therefore essential for financial planners to ensure client fact-finds and research into ESG investing are both comprehensive and considered.

1.6

The jargon

As you can see from the previous section, ESG is a world packed with specialist terminology that can make it seem impenetrable. This isn't helped by the lack of common definitions which can make it difficult for companies and investors to clearly understand the environmental impact of their decisions and can lead to consumer harms like greenwashing. The government is implementing the UK Green Taxonomy to address this and you can learn more about that in the Regulatory requirements section of this guide.[9]

In the meantime, section 10 of this guide includes a glossary designed to provide you with the most generally accepted current definitions of much of the most used language to help you navigate this report and the ESG universe.

The current context

2.1

Drivers

Enviromental and economic imperatives

The most high profile issue that has been driving the ESG agenda in recent times is, of course, climate change. This is largely because of the urgency of the problem and the extent of areas - in terms of countries, populations and activities - wherein policies, laws and actions need to shift to avoid catastrophic, yet preventable outcomes.

The difficulties and threats are stark. The latest United Nations Production Gap report (United Nations, 2021) finds that governments plan to produce more than twice the amount of fossil fuels in 2030 than would be consistent with limiting long-term warming to 1.5°C above pre-industrial levels.[10] Looking further ahead, analysis suggests the pledges made for the COP26 meeting in Glasgow secure less than half the reduction in emissions needed to be consistent with the 2050 Net Zero objective[11].

> ***Climate change is the single greatest threat to a sustainable future.***
>
> **BAN KI-MOON, FORMER SECRETARY GENERAL OF THE UNITED NATIONS**

The consequences of the additional 0.5°C would be significant: More than twice as many of the world's population would be exposed to extreme heat waves. The rise in sea levels would engulf many island states. The rate of biodiversity loss, such as insects and plants, would double or triple. The drop in global annual catch for marine fisheries would double to 3 million tonnes, while yields of maize, rice, wheat, and potentially other cereal crops would face increased decline. The number of people worldwide who are exposed to climate-related risks and resulting poverty would likely rise by hundreds of millions[12].

But the problems with nature and the environment don't exist in a bubble with no economic consequences. For some lucky first-worlders, this may have been the case in the past, but it is certainly not the reality moving forward as worldwide and UK GDP are very much at risk.

The Bank of England's Climate Biennial Exploratory Scenario has found that taking action now with carbon taxes and other policies leading to gradual change towards net-zero by around 2050, impacts some sectors adversely, but mutes the overall impact on GDP. However, a ten year delay leading to a more sudden and disorderly transition by 2050 results in material short-term macroeconomic disruption affecting the whole economy. The result is a contraction in output in the UK and international economies and a sharp fall in GDP, reducing employment, with knock-on consequences for demand, spending and multiple financial markets.

Even worse, with no action, global temperature levels continue to increase, bringing about physical changes that create permanent impacts on living and working conditions, buildings and infrastructure. UK and global GDP growth is permanently lower and macroeconomic uncertainty increases. Many of the impacts from physical risks are expected to become more severe later in the 21st century, so the headwinds facing the economy would be expected to increase further into the future[13].

GDP impacts in international scenarios

	United Kingdom	Euro area	United States	China
Early Action	-1.4%	-1.2%	-1.6%	-1.8%
Late Action	-4.6%	-4.9%	-3.8%	-5.3%
No Additional Action	-7.8%	-10.2%	-11.2%	-15.3%

SOURCE: BANK OF ENGLAND CLIMATE BIENNIAL EXPLORATORY SCENARIO

Generational demand and the human condition

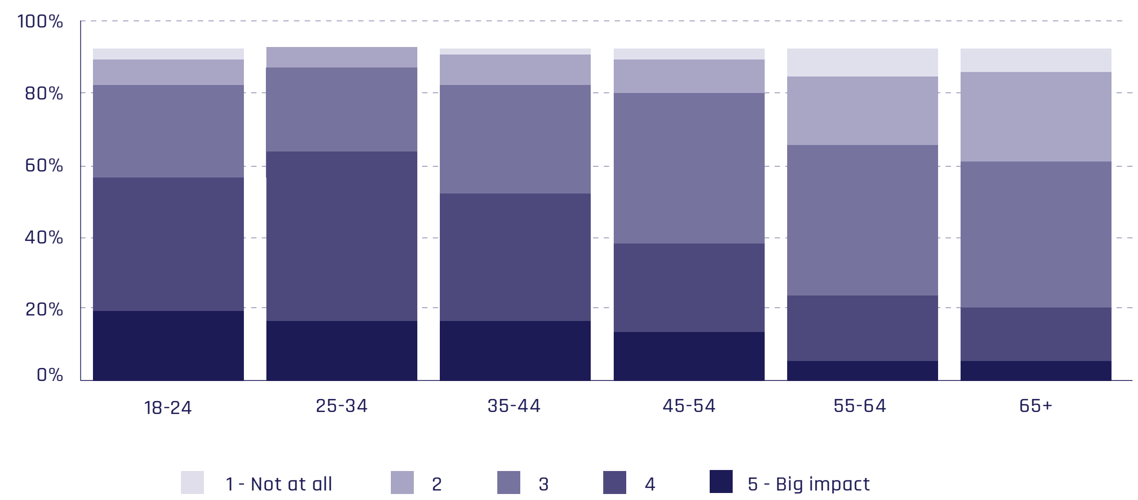
The notion that younger generations are more inclined to take action so that their future is protected is a logical one and there are plenty of statistics to support it: Research published by Saltus Wealth Index in November 2021 found that 80% of 18 to 24-year-olds with more than £250,000 in investible assets invest in ESG, green or impact funds, compared to just under a quarter of over-65s. In fact, young investors are more than three times as likely to invest in ESG than those aged over 65[14].

But, more than just personal interest is taking centre stage for younger people. Social justice and inequality is also a growing priority, partly because under-40s in general tend to be better educated about social and governance elements than their parents. That brings with it other considerations for financial advisory firms, which increasingly need to recognise that if you're going to hold other companies to account, you have to start with your own business[15].

Having highlighted the drive of younger generations to fix the ESG issues, although millennials have driven the trend of 'investing for good', studies suggest people across the generations are taking an interest. It is clear that interest in sustainable investing is strong among all generations of investors.

The human condition dictates that generally, people want to do things that are meaningful and make them feel good about themselves. The disquiet with the clear and ongoing 'cause and effect' of decades of ignoring the wider negative connotations of 20th and 21st century business practice and political policies has prompted growing social and environmental awareness among all generations. And whether it's motivated by guilt, anger or altruism, any client could now demand that their money makes a life enhancing difference and not just a financial return.

On average, do you think responsible investments make a tangible difference to the environment or society in general?



SOURCE: SALTUS WEALTH INDEX 2021

Thought Leadership

PROFOUND RE-EXAMINATION OF PURPOSE IS THE FIRST STEP TO NEW OUTCOMES

JOHN FEATHERBY
SHOREMOUNT

I am not advocating here for the authorship of a purpose statement, as has become common practice in some consulting and corporate circles. Rather to explore "purpose" in a localised and ongoing manner: what really matters, why we should pursue it and who we are becoming in the process.

What we must wrestle with is a changing worldview and ESG, as one of its derivative concepts, is rooted in this reality. Without recognising this, ESG risks becoming relegated to a utility framework imposed on investment teams with little power, just as a singular, fixed purpose statement does.

Unfortunately, "better governance" too often tends to mean "more policies and control mechanisms". But what it should be focused on is higher quality relationships, deeper trust and a collective sense of direction. Purpose is therefore a deeply human question (philosophically and spiritually) before it is an organisational or economic one.

Being purpose-led is to fundamentally reimagine success around a more interdependent perspective: a harmony of interests. Often this requires external challenge from beyond the professional wheelhouse because, without it, boards tend to come up with "new ideas"that, in reality, are based on the same assumptions and mindsets that produced today's problems in the first place.

What are some simple steps to start going about this? Small, high quality discussion groups - as wide as you are willing to take them - are always part of the solution; such formats have long been society's most powerful agent of change and today is no different. You do not need a complex consulting framework to make a difference. Secondly, you need good questions. Corporate life is much too focused on reaching an answer: "just tell me what to do!". Spend more time on picking your question. Lastly - and vitally - recognise that the discussion itself is the key output, not the content it may generate.

Some questions that might help could include:

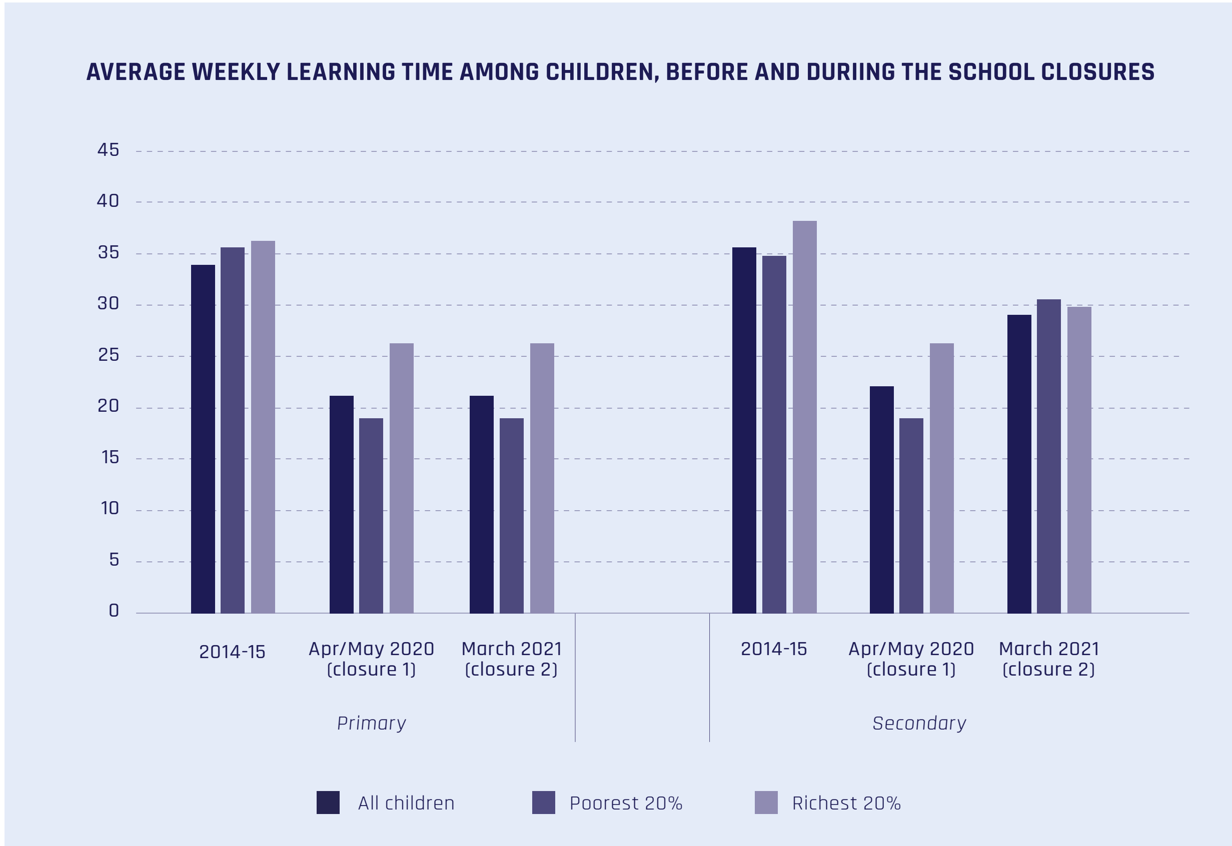
- How am I contributing to the problems we face? (keep the conversation on those in the room and what you can control)
- Why does this change matter to me personally? (personalises and builds trust, not over-professionalises the issue)
- What are my underlying beliefs or assumptions about people? (shifts the dialogue to typically unspoken issues)
- What price am I willing to pay to see this succeed? (counterbalances the ubiquitous cost and money questions)
- What are our doubts and reservations about moving forward? (shifts it from a sales or obligation exercise to a real choice)
- What might be the cost of inaction? (explores reality that no change is not a neutral choice)

Covid as an accelerator

The economic and health inequalities pinpointed by the coronavirus pandemic have played a major role in bringing into focus both local and global concerns. The profound impacts on society have highlighted issues of systemic unfairness and pricked the collective conscience. Royal London found evidence of this when it reported that it's 2021 consumer survey found that 73% feel that a lesson learned from the covid pandemic is that, if we all work together, we can have a positive impact on climate change[16].

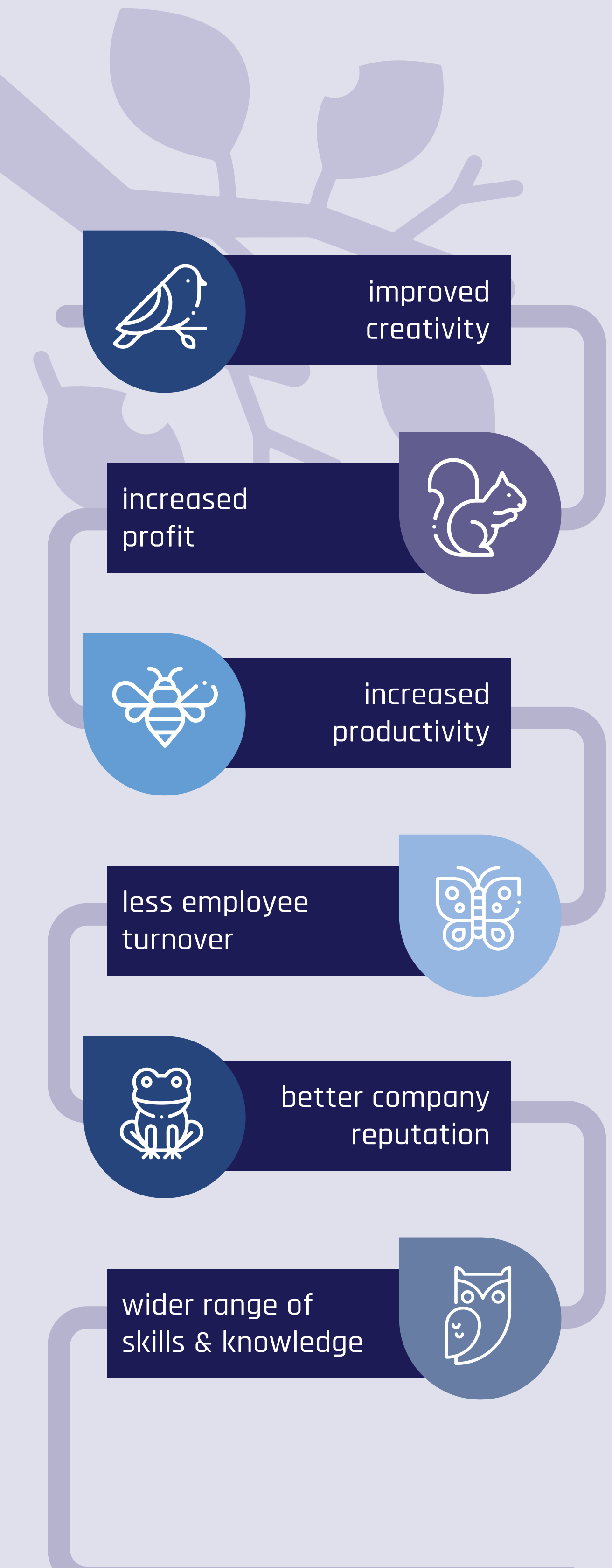
In the UK, the Institute for Fiscal Studies has noted the impact of school closures disrupting the learning of poorer children, leading to lower attainment, the worsening of mental health for those groups (women and younger adults) who had poorer mental health pre-pandemic and the reduction in the ability of younger, lower-earning, and less educated people to work thanks to lockdowns and social distancing[17].

Internationally, just over 7% of people in low-income countries have received a vaccine dose compared to over 75% in high-income countries. In addition, the pandemic has resulted in extreme poverty rising in 2020 for the first time in over 20 years, leaving around 100 million more people living on less than $1.90 a day[18].



SOURCE: INSTITUTE FOR FISCAL STUDIES

Diversity benefits



Regulatory direction

The government has placed a growing emphasis on ESG-related issues over the last five years, reaching a crescendo of policy and discussion papers around the time of the COP26 UN Climate Change conference in November 2021. One of Boris Johnson's 2019 election manifesto promises was to reach Net Zero by 2050 and his levelling up agenda aims to even out the sorts of inequalities that Covid has exacerbated.

In line with government policy, the FCA's Business Plan, 2021/22 makes ESG one of its six cross-sector priorities for the year ahead. In the net-zero journey it talks of, "adapting our regulatory framework to enable a market-based transition seeking outcomes including, high-quality climate and sustainability-related disclosures to support accurate market pricing, helping consumers choose sustainable investments and drive fair value and ensuring that regulated firms have governance arrangements for more complete and careful consideration of material ESG risks and opportunities."

Diversity is another of the FCA Business Plan's cross sector priorities and is arguably its most visible contribution to the social and levelling up issues Mr Johnson has discussed addressing. The regulator views diversity and inclusion as a key component of ESG – both in its own right, and as an enabler of creative solutions to other environmental and social challenges.

This is set within the context of multiple international research projects which have noted compelling findings where a broader range of ethnicities, sexualities, genders, religions, ages, socio-economic backgrounds, and physically and mentally abled staff are present in a company. The benefits include a reduction in 'group-think', with different viewpoints offering new and innovative thinking[19].

The FCA's target outcomes are for regulated firms and listed companies to have more diverse representation at all levels, to foster cultures that are inclusive so that staff can share their diverse experiences and backgrounds, and to design and deliver products that reflect the diverse needs of consumers, offer fair value and are delivered in a fair and accessible way[20].

Employers with more than 250 employees are already required to report their gender pay gap, with others encouraged to report voluntarily on the ethnicity pay gap. The Bank of England, Prudential Regulation Authority and FCA's July 2021 joint discussion paper,'Diversity and inclusion in the financial sector – working together to drive change', set out their thoughts on policy options to boost representation, including linking managers' pay to their performance on inclusion goals[21].

2.2

Opportunities

A feel-good conversation and value-add advice

The power of positivity can be a useful commercial tool for financial advisers and being the professional who opens clients' eyes to ESG possibilities could make you their most memorable and valued professional adviser. Where core values include a desire to put compassion or humanitarian beliefs into action alongside robust financial plans, consider how empowering this could be.

Bearing in mind research currently suggests that less than half of clients are aware of ESG, let alone understand it[22], advisers who actively

enquire with clients about goals beyond purely financial ones and who can then offer some clarity on the potential options, stand to make a very useful impression. And a big step to addressing all of their clients' objectives.

At the moment, those advisers are likely to be in the minority: Research from Aegon and Next Wealth has found that over half (52%) of financial advisers consider ESG criteria only at the client's request when building retirement portfolios[23]. When it's considered that a pension is probably an individual's biggest investment outside of buying a house, and therefore one of their greatest chances of making both a financial nest egg for themselves and an ethical mark on the world, that signals a myriad of lost opportunities.

One of those could be for your advice business. Mark Carney, former Governor of the Bank of England and United Nations special envoy for climate action and finance, puts it plainly:

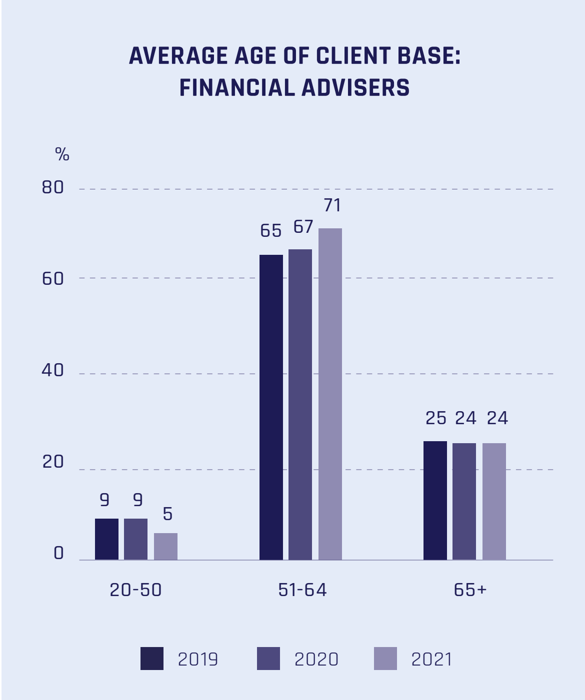
Companies that don't adapt will go bankrupt without question. But there will be great fortunes made along this path aligned with what society wants.

Addressing the next generation

The client banks of financial advisers are ageing, with 71% having clients with an average age of 51 - 74[24]. As a result it is essential that advisers find ways to engage with the next generation. Millennials, who are currently the recipients of a huge and ongoing transfer of wealth, and Generation Z, will rapidly become the core work source of advice firms.

Sustainability expert and bestselling author Marga Hoek recently stated that a 2020 UK business review showed that financial advisers are the second-most trusted profession when it comes to ESG investing, and IFAs need to see that as a positive thing so they can educate themselves and their clients[25].

Identifying the most important issues to upcoming clients is key, especially in a world where social media and fast-paced communications, any time or place, mean competition is keen. Effectively capturing the attention of younger people can leverage their understandable impatience for change by actively addressing both their financial and ethical concerns.



SOURCE: SCHRODERS

Differentiating your practice and making a difference

Since we know that many financial advisers are not engaging with ESG issues, those that do will reap some of the benefits of 'first-mover' status. Not only will they have access to more potential clients, but they will have additional touch points for client conversations.

COP26 has given those conversations about sustainable investing a particularly current feel and advisers the opportunity to not only build relationships, but also to demonstrate how well-informed they are. Offering appropriate investment options offers clients a chance to invest in line with the global direction of travel, to take action and do their bit[26].

Even those whose motives are purely financial may, and probably should, have an interest in ESG issues since many are globally important and shifting paradigms in the way that we live our lives and spend our money. So, when it comes to risk mitigation as well as allaying the fears of all investors, these considerations need to be taken into account. In fact, it is likely that many clients are actually unaware of the possible far-reaching financial consequences of some of the concerns that ESG investments are attempting to correct, making education in this area a potentially important eye-opener.

Not only can that education facilitate a broader understanding of how achievable individuals' financial goals are, but it can open the route to the responsible investment that is so badly needed. Research from Royal London shows that once people recognise that their long-term savings can make a difference, the proportion of those who say they would prefer their pension to be invested responsibly jumps from 7% to 57%[27].

While sustainable investment is a lofty goal, client satisfaction with financial planning and investment advice and directing suitable funds to sustainable investments is not where ESG considerations end for financial advisory firms. Those who are interested in sustainability don't simply view ESG as something that investments should be targeting. They see it as something that everyone should be working towards, including financial advisory firms.

This means that, beyond the external advantages of getting involved in the ESG agenda, advisers should be looking at the internal actions of their companies as a means to differentiate themselves from their rivals. Such actions can not only evidence good culture to the FCA, but also drive positive developments in the way firms treat their staff, act within their communities and respond to their social responsibilities, with the additional likely benefits of driving up staff morale and sustainable practices. For some thoughts on how to build your firm's ESG knowledge, credentials and proposition, take a look at the Practical tips section of this guide.

Top 5 opportunities for the year ahead, according to advisers

25% Estate Planning

23% Intergenerational wealth planning

23% Responsible investment

20% Taxation planning

83% Retirement planning

SOURCE: ROYAL LONDON

Thought Leadership

A DIFFERENT KIND OF VALUE INVESTING

WHITNI THOMAS

HEAD OF CORPORATE FINANCE,
TRIODOS BANK

With such a focus on environmental issues recently – for example with the UK hosting the COP26 UN climate summit – it can sometimes feel that it's the E of ESG that matters most. We know that if we don't act urgently on environmental matters, then we risk damaging our planet irreparably. But where the impact of climate change is being felt most today – with floods, droughts, or fires – it's people who are suffering. Environmental and social impact are intrinsically connected.

Although ESG may seem like a new phenomenon in the world of finance, Triodos Bank was founded over 40 years ago, with a mission to promote quality of life for all in the broadest sense and for the long term. Its founders wanted to use money to solve some of the most pressing challenges facing society. The aim has always been to use money consciously today, without compromising the needs of future generations. Triodos remains a bank that is focused on impact, connecting those who have money to invest with entrepreneurs and projects to drive forward positive change. Through our loans, funds and direct investments, we put finance to work for the benefit of people and planet.

What does the 'S' of ESG look like in practice? It means supporting organisations that are working with disadvantaged individuals or marginalised communities, helping to ensure everyone has access to education, health and social care, a safe place to live and the ability and skills to work and contribute to society. For us this means helping Jamie's Farm to open four farms to support the development of vulnerable young people in an agricultural setting. It means helping the charity Thera Trust to support more people with a learning disability to live independently. And it means enabling the social enterprise Birtenshaw Group to double capacity in its special needs schools, so that more pupils with complex needs have access to its specialist provision. Our diverse portfolio contains many such organisations.

Opportunities exist for individuals to save and invest for social impact through their choice of where they bank, where they deposit their savings, what investments they make and how they save for retirement. Choosing investments and building portfolios including positive impact considerations is more work, but so are most things worth doing. There are social impact funds and impact driven asset managers who have 20+ years' track record spanning several economic cycles.

The advisers we speak to tell us that talking about impact and values alignment enables them to have more meaningful conversations with their clients and understand them and their goals better, to ensure they can provide them with the right advice and support. As the impact investing market continues to develop, more tools and guidance are available for advisers to enable them to do this more efficiently.

Positive impact investing isn't a passing trend: it's here to stay. As more of us understand the impact that all investments have, many more of us are choosing to ensure that this impact is as positive as it can be. In doing so, we are using our money to create the world that we and our children want to live in.

Aligning with the regulator

These actions, as well as those involving investment recommendations, are very much included in the FCA's regulatory focus. It has stated that,

> ***we are keen to promote positive innovation in green finance. We support firms that are seeking new ways to mitigate climate risk and enable consumers to take advantage of the opportunities that the transition to net zero offers[28].***

Of course, firms that are comfortable with, and prepared for new FCA requirements are much less likely to find themselves on the radar for supervisory attention. The regulator has already mentioned its intention to supervise proactively to promote firm behaviour in line with its expectations, as well as to, " highlight best practice and put pressure on laggards[29]."

It's not surprising then that McKinsey has found that strength in ESG helps reduce companies' risk of adverse government or regulatory action in all sectors. For banks, the closest proxy for financial services, the estimated share of EBITDA at stake from issues including systemic regulation and consumer protection is between 50% to 60%[30].

The ESG-related opportunities in EIS, VCT and BR

In his Ten Point Plan for a Green Industrial Revolution, Prime Minister Boris Johnson announced that the Green Industrial Revolution will create 250,000 "highly skilled" green jobs and £12 billion will be invested across clean energy, transport, nature and innovative technologies.

Some of this investment could well be made through tax-advantaged investment structures, offering investors a spot on the ground floor of fast-growing disruptors. The former governor of the Bank of England, Mark Carney, called net zero the "greatest commercial opportunity of our time" and there is plenty of scope for Enterprise Investment Scheme (EIS), Seed Enterprise Investment Scheme (SEIS), Venture Capital Trusts (VCT) and Business Relief (BR) investors to tap into this.

While, at any one time, there can be well over 100 open SEIS, EIS, VCT and BR offers, the number that currently specifically identify themselves as ESG-friendly in their names barely reaches double figures. However, many other offers may well overlay an ESG integration strategy over their search for potential investments.

EIS, SEIS, VCT and Business Relief: The basics

The Enterprise Investment Scheme, Seed Enterprise Investment Scheme and Venture Capital Trusts are government schemes designed to encourage investment in the shares of small and medium-sized enterprises (SMEs) that have a permanent establishment in the UK. Established in 1994, 2012 and 1995 respectively, the schemes offer generous income tax and capital gains tax relief to individuals as an incentive to invest in SMEs and social enterprises that are not listed on any recognised stock exchange, although AIM quoted companies are eligible.

Business Relief, previously known as Business Property Relief, established in 1976, is a statutory relief, enshrined in law. Its original purpose was to prevent small businesses having to be broken up and sold to raise the funds required to pay the IHT liability when the business owner passed away. After being extended from business owners to qualifying minority shareholders in a qualifying company in 1996, managers who specialise in these investments began launching estate planning services.

Disruptive SMEs

SEIS, EIS and VCT investors back ambitious, early-stage companies to help them achieve long-term, sustainable growth. These government schemes bring a huge focus to small and medium sized entities (SMEs), and particularly to young companies with entrepreneurial leadership and disruptive ideas. PwC calls entrepreneurs, “the instigators of innovation and transformation,” and, “critical players in making the art of the impossible, possible. They are a proven cohort for bringing novel technologies and disruptive approaches to industry, and in doing so inventing a new future[31].”

The speed, agility and expertise with which ingenious young businesses have contributed to Covid-19 research and recovery is proof of their value in the current context. One example is Tended, an investee of Blackfinch via its EIS offer, Blackfinch Ventures EIS Portfolios. A wearable technology firm, Tended had an exceptional 2020, developing a highly accurate social distancing product now used by organisations including the BBC and Rolls Royce.

These change-makers also offer significant growth opportunities but they need nurturing, financially and commercially and not everyone is willing to risk money on the new or unproven. Consequently, many of these companies lack the early-stage funding to bring their ideas to fruition and achieve their potential. This is where incentivising investment through tax reliefs has been successful for decades in bringing ‘outside the box’ thinking and the solutions it brings to a wider audience. It’s also why the role played by these venture capital funding schemes is more vital than ever.

The tax reliefs on offer are certainly attractive.

	VCT	EIS portfolio/fund	SEIS	BR
INCOME TAX RELIEF	30%	30%	50%	No
MINIMUM HOLDING PERIOD	5 years	3 years	3 years	2 years
LIKELY INVESTMENT HORIZON	5-10 years	5-10 years	5-10 years or more	5 - 10 years (must be held at death)
MAXIMUM ANNUAL INVESTMENT ELIGIBLE	£200,000	£1m plus £1m carry back (£2m where at least £1m is invested in knowledge-intensive companies)	£100,000	unlimited
DIVIDENDS	Tax exempt	Taxed	Taxed	Taxed
CAPITAL GAINS	Tax exempt	Tax exempt	Tax exempt	Taxed
CGT DEFERRAL/ EXEMPTION	No	Yes - CGT deferral	Yes - CGT exemption	No
IHT RELIEF	No	100% after 2 year holding period	100% after 2 year holding period	100% after 2 year holding period
LOSS RELIEF	No	Yes	Yes	No
LIQUIDITY	Up to 20% of the VCT’s assets (30% for accounting periods beginning before 6 April 2019) may be held in cash, or certain other liquid assets. VCT managers often offer share buyback schemes but usually at a discount to NAV and they are not guaranteed. VCTs’ shares are not widely traded and usually trade at a discount to their NAV.	There is no large-scale active secondary market in unquoted shares and EIS managers do not offer buy-backs. Investors should regard themselves as locked in to the shares until the underlying company either lists on a recognised stock exchange, achieves a trade sale, or the company is wound up. AIM listed EIS-qualifying shares have the potential for faster disposal.	There is no large-scale active secondary market in unquoted shares and SEIS managers do not offer buy-backs. Investors should regard themselves as locked in to the shares until the underlying company either lists on a recognised stock exchange, achieves a trade sale, or the company is wound up.	There is no large-scale active secondary market in unquoted shares but BR managers offer liquidity within target timelines typically between <30 days to >3 months in normal market conditions, depending on the service.

A longer term hold for crucial less liquid investment options

It's also worth noting that not only do EIS, SEIS, VCT and BR require minimum holding periods to qualify for the tax reliefs, but 2017's Patient Capital Review has ensured that EIS, SEIS and VCT funding is targeted at longer term investments with likely investment horizons at 5 to ten years. Anecdotal evidence also suggests that the BR rules that require investors to be holding eligible shares at death results in their average holding period of around five years.

What's more, BR encourages equity investments to be bequeathed and handing them over to new generations with a built in ESG feature, may mean new generations are less likely to simply sell and invest elsewhere, where they have a greater interest. Not only does this have the potential to dilute the ongoing family legacy with the associated financial costs that accompany divestment and investment, but also entails the removal of growth capital from the original underlying investment.

In addition, while liquidity may be available, it is not guaranteed in any of these tax-advantaged structures. As a result, they are well placed to invest in less liquid assets that can have a large environmental or social impact such as renewable energy.

High-frequency trading is a symptom of a much deeper malaise, where we expect financial returns over shorter and shorter timescales. Trading is so fast that there is little or no time to consider wider consequences, intended or unintended[32].

AVIVA INVESTORS, SEPTEMBER 2021

Underlying investment focus

A very broad spectrum of trades qualify for SEIS, EIS, VCT or BR status and investment managers in this space include those with a specific sector focus and the know-how to drive performance in that area, as well as those that are generalist and cast a wide net for the best opportunities. In both cases, some have been selecting underlying investments via an investment process that takes into account ESG considerations for some time.

With the accelerating pace of the global transition towards a net zero economy, renewable energy projects can have a direct impact on sustainability goals. In addition, the events of late 2021 that led to supply shortages of natural gas and elevated energy prices globally, may prove to be an additional driver allowing nations greater control of their energy security as higher proportions can be garnered from local natural resources such as wind and solar farms.

While energy generation firms do not currently qualify for SEIS, EIS or VCT, renewable energy has been a popular sector for BR investment managers for a number of years. Therefore, not only can investors with those managers potentially benefit from access to substantial expertise in renewables, but also from the long-term income streams energy generation is associated with. In the past, generous government feed in tariffs guaranteed those income streams from green energy sources.

Technology is another favoured sector, particularly among SEIS, EIS and VCT managers. Global decarbonisation, for example, will require new applications for the measurement, monitoring and recording of progress by all sorts of organisations - making climate tech an important market. Technological advances can also facilitate the development of both planetary and population health.

Sustainable lifestyle and wellness is targeted by some managers and others look to biotech and pharmaceuticals to resolve medical threats, including Covid-19. Other areas such as managed forestry and construction are capitalising on the growing appetite for wood-based substitutes for plastics and sustainable infrastructure.

Nick Britton, Head of intermediary communications at the AIC, says there is a growing awareness among investors in tax-advantaged investments that they can provide avenues to non-financial benefits: Of VCT investors, "almost nine in ten investors in VCTs say that it's important to them that VCTs help support the UK economy. Four in five feel that by using VCTs they're backing cutting-edge science such as innovations in healthcare. Two-thirds appreciate they can support green technologies by using VCTs."

This is important, as Mark Brownridge of the Enterprise Investment Scheme Association (EISA), feels that, "Going forward, it's clear that innovation will also be key to addressing the challenges of climate and social change." As a result, "EIS and VCTs history of innovation and funding entrepreneurs who affect change and the noble and much needed aims of ESG would seem to be an excellent investment match."

Of course, investing in early stage companies is a risky strategy and generally, they should only be considered as part of a diversified portfolio.

	Underlying investment case study: Culture Shift
SECTOR	HR Tech
ACTIVITY	A real-time reporting platform to identify and prevent harassment and bullying
ESG FOCUS	Enhance the standards of equality, safety and staff wellbeing in the workplace
BUSINESS DRIVERS	69% of LGBT people have been sexually harassed at work[33], 65% of black and ethnic minority people have been racially harassed at work[34], 34% of women and 23% of men have been bullied at work[35], 30% of bullied employees leave[36], £30,000 is the average cost to replace an employee[37], £26,000 is the average sum awarded for a discrimination claim[38], organisations with inclusive cultures are 8 x more likely to achieve better business outcomes[39]
TAX-ADVANTAGED INVESTMENT	EIS: £274,000. VCT Investment: £500,000
INVESTMENT MANAGER	Blackfinch
GROWTH	5x growth in the 12 months to August 2021. Zero churn on over 70 customers. 175% annual recurring revenue (ARR) increase in 2020 and 3.3x growth in 2021

Stewardship

Another advantage of SEIS, EIS and BR investments is that they come with voting power: For very early stage companies like those found particularly in SEIS and EIS investments, the portion of shares in the company held by S/EIS investors and/or VCTs can be high and their influence substantial, as can the impact of the S/EIS and/or VCT fund manager. This may not be quite so potent where BR, VCT, and EIS investees are AIM listed and there is scope for many more individual and corporate shareholders, but the vast majority of EIS funds do not invest in AIM listed companies, while around half of BR managers focus on non-AIM investees.

However, VCT managers may still control impactful blocks of shares in AIM listed companies (the VCT is the shareholder rather than individual investors as is the case for S/EIS and BR) when important investee decisions are made. Although, the power of this kind of stewardship of investee decisions will depend on the volume of shares owned and any alignment with other voters with ESG concerns, many clients will like the idea of investing in structures that allow them a say or with a manager that can apply pressure on their behalf.

Growing up as ESG natives

Even more positively, the small, young businesses that populate the S/EIS and VCT universe (and sometimes that of BR) may be much more likely to be born and grow with ESG principles already embedded in their DNA. Where this is not the case, integrating ESG factors at the very early stages of a company's growth can be much easier than for established firms and ensure that best practice becomes part of the fabric of their operations.

2.3

Risks

Loss of current and future clients

Any lack of awareness and knowledge among financial advisers will inevitably open the door to competitors looking to usurp ESG business as demand for advice in this area grows across all generations. The cost of this is not just future business and fees.

According to recent estimates, the cost of acquiring a new client can be up to £500 or more[40]. But that is without taking into account the time and energy required to onboard that client, which has been calculated at around £1,500[41].

Bad investment outcomes

There are multiple factors that threaten positive investment results if ESG concerns are not addressed or taken into account when considering investment recommendations. They include:

Losses resulting from firms failing to respond to the evolving policy environment[43].

Losses from investments in activities that become heavily taxed or outlawed in the future.

Losses as a result of investments in activities that are disrupted by cleaner/more socially responsible methods.

Losses associated with legal issues. Legal commentators expect the pace of ESG-related litigation to continue to increase and take in not just climate change issues, but other ESG concerns, particularly in the light of new disclosure regimes. Greenwashing claims (from regulators, shareholders, and other stakeholders) may increase as green marketing and ESG commitments become ever more important to consumers and investors[48].

Losses from the physical effects of climate change on asset value[42].

Losses relating to stranded assets: As investment managers exclude increasing numbers of solutions that do not meet the criteria for the transition to net zero, those companies may simply become unattractive for investors. They may become 'stranded assets' meaning assets that have suffered from unanticipated or premature write-downs, devaluation or conversion to liabilities[45]. Estimates of losses that will be incurred from stranded assets suggest they may run to tens of trillions of US dollars[46].

Losses as a result of climate risks are not yet being internalised within asset valuations to reflect various climate change scenarios, suggesting that investors do not pay sufficient attention to climate risk[44].

Reputational issues. A good (or bad) example of this is fashion retailer Boohoo which saw its share price tumble in 2020 after it was found to be paying sweatshop wages. The power of social media to widely and quickly disseminate news and opinion heightens this issue as do the growing instances of consumer rights organisations and other groups taking legal action against firms making misleading claims[47].

Blocking crucial change

Outside the commercial issues is one which is driven much more by personal conscience, but even that could have monetary consequences because a rising number of people are now looking for businesses with a moral compass.

The FCA has all-but labelled financial advisers not fully engaging on ESG as an obstacle to a better future, saying in its Climate Change Adaptation Report that, “Lack of ESG expertise is a hindrance to some of the largest investment advisers. So complex jargon, opaque information and the inability to separate out the ‘E’ from ESG metrics and considerations compound to act as a barrier to retail investors’ adopting climate-friendly investment practices.”

Firms increasingly face both ‘physical’ risks as the climate changes around us and ‘transition’ risks from the move to a net-zero carbon economy. If poorly managed, these risks could be the source of consumer harm and potentially a future financial crisis stemming from financial losses and sudden adjustments in asset values.

THE CLIMATE FINANCIAL RISK FORUM GUIDE, JUNE 2020

A strong ESG proposition links to value creation

	STRONG ESG PROPOSITION (EXAMPLES)	WEAK ESG PROPOSITION (EXAMPLES)
TOP-LINE GROWTH	Attract B2B and B2C customers with more sustainable products Achieve better access to resources through stronger community and government relations	Lose customers through poor sustainability practices (eg, human rights, supply chain) or a perception of unsustainable/unsafe products Lose access to resources (including from operational shutdowns) as a result of poor community and labour relations
COST REDUCTIONS	Lower energy consumption Reduce water intake	Generate unnecessary waste and pay correspondingly higher waste-disposal costs Expend more in packaging costs
REGULATORY AND LEGAL INTERVENTIONS	Achieve greater strategic freedom through deregulation Earn subsidies and government support	Suffer restrictions on advertising and point of sale incur fines, penalties, and enforcement actions
PRODUCTIVITY UPLIFT	Boost employee motivation Attract talent through greater social credibility	Deal with "social stigma" which restricts talent pool Lose talent as a result of weak purpose
INVESTMENT AND ASSET OPTIMIZATION	Enhance investment returns by better allocating capital for the long term (eg, more sustainable plant and equipment) Avoid investments that may not pay off because of longer-term enviromental issues	Suffer stranded assets as a result of premature write-downs Fall behind competitors that have invested to be less "energy hungry"

SOURCE: MCKINSEY

Performance

3.1

Financial returns

It used to be a common belief that investments focused at purpose rather than just profit came at a cost. But there is now weighty research evidence from respected sources proving that this is not the case. Here is just a small sample of the findings:

S&P Global Market Intelligence

Tracked 27 US-based ESG exchange traded and mutual funds with more than $250m in AUM each, between December 2020 and May 2021. 16 outperformed America's S&P 500 index. The ESG funds rose between 11% and 29.3% during the period versus 10.8% for the benchmark.

BNP Paribas

Reviewing a range of sustainable equity indices over the five years to 2021 revealed that they have outperformed standard non-sustainable benchmark stock indices; the MSCI World SRI (Socially Responsible Investing) index has seen a 14.1% compound annual growth rate (CAGR) in returns since the beginning of 2016, 1.1% more than the MSCI World standard benchmark[49].

Morgan Stanley Institute for Sustainable Investing

Sustainable investing funds were found to have outperformed traditional funds and reduced investment risk throughout 2020, enduring pandemic-generated volatility better than their counterparts by way of strong risk and return performance.

So, there is evidence an ESG slant can actually offer risk mitigation. Those advisers concerned that the combination of SME investing with sustainability goals equals an uninvestably high risk profile, should think again.

While the tax-advantaged investments space is somewhat less mainstream than those featured in many studies, it does have some size and influence: The VCT sector alone holds £6.3 billion of assets[50]. And the performance of SEIS, EIS, VCT and BR offers during Covid-19 shows the resilience of small, young, private companies, as well as their growth potential.

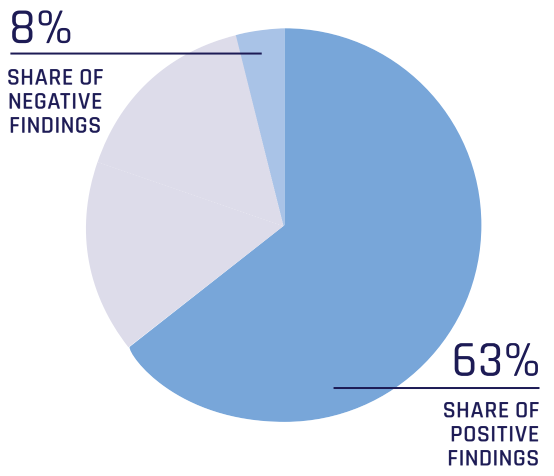
According to data from MICAP which provides independent due diligence and research into the alternative investment market, BR offers focused on unlisted investee companies have posted annualised returns of between 1% and 5% since inception, while BR offers focused on AIM-quoted investees have posted five year returns of between 102% and 32.2%. Meanwhile, return multiples for EIS funds range from 2.7x to 0.8x (realised and unrealised assets)[51].

The Association of Investment Companies’ Nick Britton has reported that VCTs, “had a good year in 2021, delivering an average total return of 24% (excluding tax reliefs). While this included an element of post-pandemic bounce-back, it’s worth bearing in mind that 2020 was far from disastrous, with VCTs eking out a positive 4% return in that year.” It’s also worth noting that AIC analysis has found that the average VCT returned 155% over the last ten years[52].

However, when a client invests in a “top-up offer” (the most common kind of VCT offer), that client gets immediate access to a VCT’s existing portfolio. While this provides a useful “diversification of maturities” and the potential opportunity to tap into instant income, it could also mean there are investees that perhaps don’t meet any current ESG filters applied by the investment manager.

Paying attention to enviromental, social, and governance (ESG) concerns does not compromise returns - rather, the opposite.

RESULTS OF > 2,000 STUDIES ON THE IMPACT OF ESG PROPOSITIONS ON EQUITY RETURNS

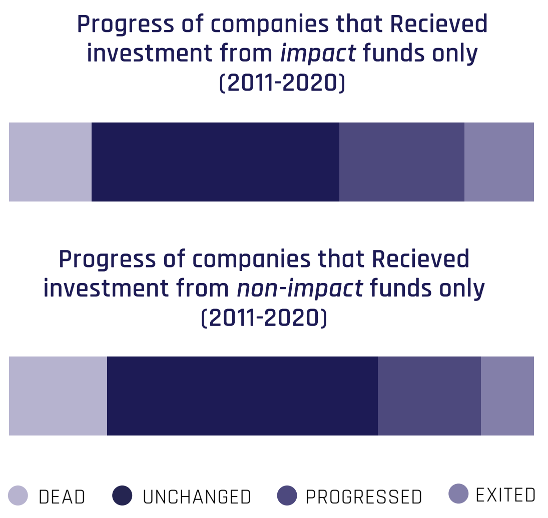


SOURCE:MCKINSEY

Meanwhile, the routes to sustainable investing for the managers of these structures are certainly on the rise. In October 2021, it was reported that the value of private London climate technology startups aiming to solve the crisis had passed £20 billion[53]. Accessing this growing cohort of companies at an early stage is, without doubt, one of the ways that the right investors can unlock the huge financial opportunities within the sustainability sector. In fact the BVCA has said of private equity and venture capital that, “This ownership model is uniquely positioned to provide the kind of capital, strategic insight and operational support that will help this new generation of enterprises to succeed at scale.”

According to analysis from Beauhurst, a data platform specialising in high-growth companies, accelerators and funds, impact or purpose-led investments are 35% less likely to fail. In fact, the data shows that UK, high-growth companies that secured an equity investment round backed by an impact investor between 2011 and 2020 progressed more positively than those that received conventional investment; A smaller proportion are now classed as ‘dead: 11% vs 17% respectively. And a higher proportion have progressed to a later stage of evolution; 23% vs 18% respectively[54].

PROGRESS OF COMPANIES THAT RECIEVED INVESTMENT FROM IMPACT FUNDS (2011-2020)



SOURCE: BEAUHURST

Interestingly, the most active impact fund in the UK by the number of announced equity investments into high-growth UK companies since 2011, has received co-investment from managers who are also names in the SEIS/EIS/VCT fund space:

The Low Carbon Innovation Fund, a venture capital fund investing alongside co-investors in SME growth businesses that help reduce Greenhouse Gases, based in the east of England typically makes investments up to £1 million. Those investments can qualify for SEIS, EIS or VCT provided the investee companies meet the relevant SEIS, EIS or VCT eligibility criteria and, while the Low Carbon Innovation Fund itself is not an (S)EIS or VCT fund, it regularly co-invests with organisations whose individual investors are able to claim those reliefs.

there is no evidence that preference for high ESG funds leads to underperformance, as other investment factors can affect results.

ESG INVESTING: PRACTICES, PROGRESS AND CHALLENGES, OECD 2020

Additionally, there is a good argument for using SMEs to diversify asset allocation across portfolios rather than giving in to the temptation of tilting exclusively towards large-cap companies where climate-friendly investments may be more about investor demand than a nuanced ESG investment strategy. Patrick Wood Uribe, Chief Executive Officer of market analysis firm Util, recommends, “Capturing companies of all sizes, addressing the full value chain of any sustainability theme, and diversifying company and sector exposure” as three good places to start[55] when building a robust portfolio with ESG ambitions.

Much of the massive inflow into ESG is from investors who realize that a strong ESG proposition can safeguard a company’s long-term success[56], whether that company is your financial advisory firm or your client’s investee. According to Morningstar data, subscriptions into sustainable vehicles reached £37.1 billion in 2021[57]. What’s more, Deloitte has projected that global ESG-mandated assets could make up half of all professionally managed investments by 2025, totaling $35 trillion.

Just like the fund performance data, accumulated research overwhelmingly finds that companies that pay attention to environmental, social, and governance concerns are actually a better financial proposition. A strong ESG proposition correlates with higher equity returns and a reduction in downside risk. The benefits range from greater ease of breaking into new markets thanks to local governing authorities having greater trust in companies with good ESG records being more likely to positively with them, to cost savings from driving down operational expenses such as energy and water, to the increased staff productivity that can result from a sense of purpose.

With large institutional investors heavily invested into a large part of the market, to reach the next level, the global ESG investment market needs to attract a broader investor base, with individuals having an important role to play.

Being a good ESG company is a kind of proxy for just being a good company...Companies that are socially responsible, diligent about corporate governance and environmentally friendly tend to be the sort of high-quality, well-managed companies that we all want to invest in.

MAIKE CURRIE, INVESTMENT DIRECTOR, FIDELITY INTERNATIONAL

3.2

Measuring ESG impacts

Your internal ESG activities

There are certainly challenges in measuring the ESG impacts of the investments clients currently make. There are all sorts of potential metrics that could help to describe success or failure where the bottom line isn't just determined in pounds, and pence.

Imagine, for example, a new company that has received EIS investment, aiming to make a difference for disabled travellers by designing digital systems allowing them to easily book journey assistance when using public transport. The investment manager might track the number of rail operators, airlines and bus companies that engage with the system as a useful quantum. Investment manager Blackfinch, which has made both EIS and VCT investments into Transreport, the real-life operator of this business model, tracks the number of assisted journeys booked each month. It ramped up quickly in 2021 to over 50,000 per month.

Alternatively, in the Business Relief universe there are a number of investment managers with investees focusing on renewable energy, with the aim of reducing carbon emissions from non-renewable energy generation methods such as coal. Such managers are in a position to report how much energy their renewables assets produce, along with how many homes this powers and the number of tonnes of CO2 emissions it has prevented. In broad terms for generation Ofgem states that one MWh is enough energy to supply the average power requirement for around 2,000 homes for an hour.

Another tracking method could be checking the voting record of your VCT investment manager. Individual EIS and Business Relief investors own the shares in the companies that are selected for them by their investment managers and consequently are free to vote on company issues however they wish. However, VCT investors invest in shares in the trust and it is the trust itself which owns the shares and therefore has block votes on company issues. This may, or may not put it in a position of substantial influence over the actions of some or all of its investees, depending on the proportion of shares it holds and allowing it a potentially important role in shaping policies and actions with ESG concerns in mind.

> ***The market is so nascent that good returns data for ESG / Impact investments isn't yet available. Moreover, the task of qualifying portfolio companies as impact investments from an outside perspective is hard: different funds have differing definitions, metrics and thresholds. It's hard to avoid comparing apples to oranges. But it's certain that the volumes of investment into these kinds of companies are growing rapidly.***
>
> **HENRY WHORWOOD, HEAD OF RESEARCH AND CONSULTANCY, BEAUHURST**

This kind of tangible data from investment managers is not only useful in making ESG progress real to investors, but is also key to understanding whether the manager and its relevant investee companies are doing what they say they are. Remember though, that the granularity of reporting in these areas is likely to vary across managers and possibly across different ESG strategies. Where VCTs have developed an ESG strategy, it's also worth noting that investments made previously may not have ESG credentials and may be positively ESG unfriendly. However, as more funding rounds are undertaken by the VCT, even if the trust does not divest itself of those shares, the portion of the portfolio these legacy investments make up, will be diluted by new investments.

Clearly, the variation in evaluation methods can make it very difficult to compare different ESG investment offers against each other. This is one of the reasons for the intervention of the FCA, which is currently considering and implementing regulatory requirements aimed at facilitating greater transparency and easier side by side comparisons. This is covered in more depth in section 4 of this guide, Regulatory Requirements.

Your internal ESG activities

There are a number of ways to track how your organisation is reacting to ESG issues and publishing the results not only demonstrates the honesty, transparency and intentionality of your business, but also allows you to report your progress. Some of the things you can do, include:

1 Monitoring staff turnover

This can be a useful indicator of employee well being which can play a key role in reducing employee turnover. While not everybody leaves because of working conditions, where staff feel happy and valued, there are fewer reasons to look elsewhere.

2 Measuring and monitoring your corporate carbon footprint

Organisations like the Carbon Trust offer online tools for small and medium sized businesses to calculate their carbon emissions based on fuel consumption of your sites and vehicles, energy consumption at your sites and top ups of fluorinated greenhouse gas to air conditioning units[58].

3 Tracking the amount of paper used by staff

A 'digital first' policy can reduce paper costs but also the deforestation, energy and water usage, as well as the carbon dioxide and greenhouse gases created in its production. It could also lower the huge waste that paper generates, as it accounts for around 26% of total waste at landfills[59].

4 Monitoring the pay gap

Dual regulated firms were required to integrate gender neutral pay policies by the FCA's 2020 Remuneration Codes, so the writing is on the wall. Despite this, data from 2021 shows that the worst performing sector for median gender pay gaps in the UK was the finance and insurance industry in which full-time male employees made on average 24% more than women[61].

5 Tracking the diversity of your workforce

Diversity and inclusion is a hot topic with the regulator, younger age groups, more socially aware clients, and investors keen to mitigate the risks of 'group think'. The HM treasury women in finance charter[60], for example, reported in 2021 that the average proportion of women on executive committees across the UK finance sector is still just 22%.

6 Tracking volunteer days and/or charity fundraising

Firms where staff are clearly committed to a purpose beyond money, demonstrate social awareness and engender community links, greater trust with clients and opportunities to organically grow their profile.

Regulatory Requirements

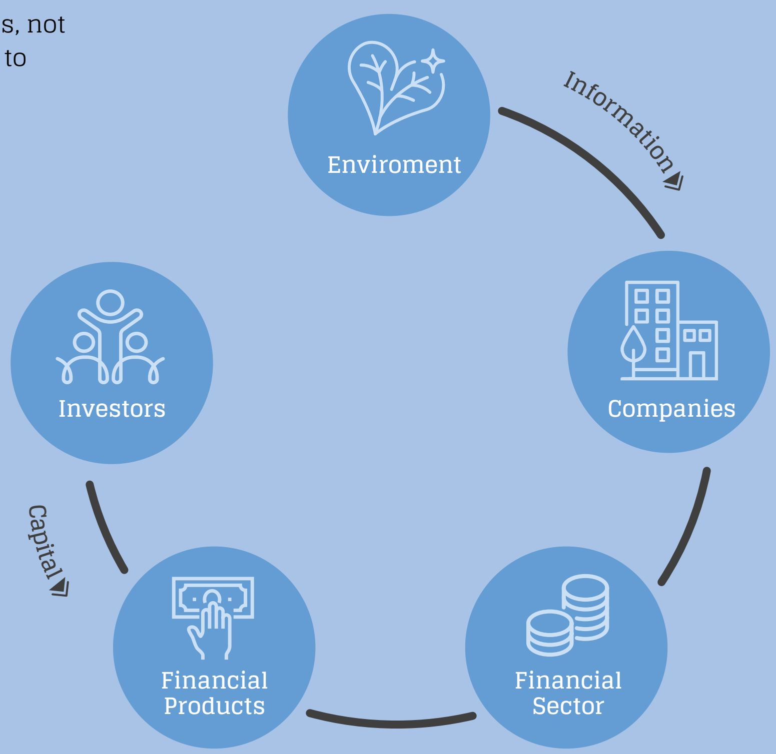
Much has been said about the requirement for uniformity in ESG terminology, data and disclosure to allow investors and businesses the information they need to understand the full range of ESG risks they face and create. When it comes to environmental concerns, which are very much at the top of the government's ESG agenda, this has been called, "a key component of every investment decision[62]."

The FCA has made it clear that, from a regulatory perspective, climate change has, "an impact on all market participants and on all of our stakeholders" and that, "change must come from across firms' and issuers' functions, not just from dedicated ESG teams, if we are to achieve our goals[63]."

4.1 Climate-related disclosure requirements

Rules changes are currently based on recommendations made by the Task Force on Climate-Related Financial Disclosures (TCFD). The TCFD aims to develop a unified framework and metrics across the economy, including Sustainability Disclosure Requirements (SDRs) implemented by the FCA. The FCA is also working closely with HM Treasury on the development of a sustainable investment labelling regime to classify investment products objectively against specified sustainability criteria.

How information and capital flows through the economy



SOURCE: GREENING FINANCE: A ROADMAP TO SUSTAINABLE INVESTING, HM TREASURY, OCTOBER 2021

At the time of publication, corporates, asset managers and investment products were subject to relatively new mandatory climate-related disclosure requirements as follow:

Dec 2020

Policy Statement PS20/17, Proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations, FCA, December 2020	
• Premium listed companies • implemented 1 Jan 2021	In scope firms must include a statement in their annual financial reports setting out whether their disclosures meet the recommendations of the TCFD and if not, why. Within scope are premium-listed financial advice firms such as Quilter, Close Brothers and Charles Stanley.

Dec 2021

Policy Statement PS21/23, Enhancing climate-related disclosures by standard listed companies, FCA, December 2021	
• Standard listed issuers • implemented 1 Jan 2022	In scope firms must include a statement in their annual financial reports setting out whether their disclosures meet the recommendations of the TCFD and if not, why. Also included is guidance to strongly encourage premium and standard listed issuers to disclose transition plans that consider the government's net zero commitment or explain why not. As a secondary market, AIM is not subject to these rules.

Dec 2021

Policy Statement PS21/24, Enhancing climate-related disclosures by asset managers, life insurers and FCA-regulated pension providers, FCA, December 2021	
• UK-authorised asset managers, life insurers providing investment products & FCA-regulated pension schemes • implemented 1 Jan 2022	In scope firms must disclose annually how they take climate-related risks and opportunities into account in managing investments. They'll also have to make disclosures about the climate-related attributes of their products. For asset managers and owners, those with £50 billion and £25 billion respectively in assets under management are now subject to the new rules. Others, with assets greater than £5 billion, will be subject to the new rules from 1 January 2023. In-scope firms must, on an annual basis, produce: • **Entity-level** – an annual TCFD entity report published in a prominent place on the main website of the firm's business setting out how they take climate-related matters into account in managing or administering investments on behalf of clients and consumers • **Product-level** – disclosures (including a core set of climate-related metrics) on the firm's products and portfolios made publicly in a prominent place on the main website of the firm's business and included or cross-referenced in an appropriate client communication, or made upon request by certain eligible institutional clients. Also included is guidance to strongly encourage in scope firms to disclose transition plans that consider the government's net zero commitment or explain why not.

Nov 2021

Discussion paper DP21/4, Sustainability Disclosure Requirements (SDR) and investment labels, November 2021	
• Sustainable investment disclosure and labels	The paper sought initial views on SDR disclosure requirements in relation to the development of consumer-facing disclosures for asset managers and certain FCA-regulated asset owners, as well as the sustainable product classification and investment labelling system. SDR will also include disclosure requirements relating to the forthcoming UK Green Taxonomy (defined as a 'common framework setting the bar for investments that can be defined as environmentally sustainable.') Over time, the SDR will extend disclosure requirements beyond climate change. The resultant policy proposals are expected in 2022.

Feb 2022

Mandatory climate-related financial disclosures by publicly quoted companies, large private companies and LLPs, Department for Business, Energy & Industry Strategy, February 2022	
• Publicly quoted companies, large private companies, and Limited Liability Partnerships • implemented 5 April 2022	In scope firms must disclose climate change related risks and opportunities, where these are material covering how climate change is addressed in corporate governance; the impacts on strategy; how climate related risks and opportunities are managed; and the performance measures and targets applied in managing these issues. The scope includes UK companies with more than 500 employees which are listed, or are banking or insurance companies, other companies and LLPs which have more than 500 employees and a turnover of more than £500 million and AIM companies with more than 500 employees. While this may impact some BR-qualifying companies quoted on AIM, any company eligible for VCT or EIS investment must have fewer than 500 employees and will therefore be explicitly excluded.

Jan 2022

New FCA handbook ESG sourcebook	
• Authorised UK firms including asset managers engaged in portfolio management and UK Alternative Investment Fund Managers (AIFMs) managing an Alternative Investment Fund (AIF)	Sets out rules and guidance concerning a firm's approach to environmental, social and governance matters, including regarding the disclosure of climate related financial information consistent with TCFD Recommendations. But A firm is exempt from the disclosure requirements in the ESG sourcebook if the assets under administration or management in relation to its TCFD in-scope business amount to less than £5bn calculated as a 3-year rolling average on an annual assessment. *"The FCA recognises that at least for a transitional period there may be data and methodological challenges. Nevertheless, we expect firms to provide sufficient information to clients and consumers. Firms should still disclose metrics and quantitative scenario analysis or examples in accordance with the rules in this sourcebook where such disclosure would remain fair, clear and not misleading. Firms should also appropriately explain any limitations on their ability to disclose and the steps being taken to address those limitations."*

TCFD Recommendations

The Task Force's recommendations on climate-related financial disclosures are structured around four thematic areas that represent core elements of how companies operate:

Governance	Strategy	Risk Management	Metrics and Targets
Disclose the company's governance around climate-related risks and opportunities.	Disclose the actual and potential impacts of climate-related risks and opportunities on the company's businesses, strategy and financial planning where such information is material.	Disclose how the company identifies, assessess and manages climate-related risks.	Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.

PRINCIPLES FOR EFFECTIVE DISCLOSURES

1 Disclosures should represent relevant information

2 Disclosures should be specific and complete

3 Disclosures should be clear, balanced and understandable

4 Disclosures should be consistent over time

5 Disclosures should be comparable among companies within a sector, industry, or portfolio

6 Disclosures should be reliable, verifiable, and objective

7 Disclosures should be provided on a timely basis

SOURCE: GUIDANCE ON METRICS, TARGETS,AND TRANSITION PLANS, TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES, OCTOBER 2021

4.2

Application of climate-related disclosure rules to EIS, SEIS, VCTs & BR

There are technical considerations that mean that not all tax-advantaged investments may currently be caught by the new rules. One of those relates to the AUM thresholds that determine whether a firm or fund is in scope or not. There is certainly a chance that the AUM of some is too low to be caught, although the relevant calculation has a wider definition than usual as it relates to any activity that is in scope of the regulations. So if a manager is the AIFM of £3 billion EIS and venture capital funds, delegated manager of a £1.5 billion BR portfolio and has an ongoing advisory mandate for another £0.5 billion with a VCT, the disclosure rules apply to all the entities that these mandates relate to because they hit the £5 billion threshold.

Then, although VCTs fit in the defined scope for listed issuers, the climate disclosure rules for listed issuers won't apply to them. This is because the FCA is of the view that, "it would be more appropriate for listed investment entities to disclose in line with our new climate-related disclosure rules for asset managers[64]."

However, even if the new rules don't apply, there are others to take into account.

4.3

Pre-existing disclosure obligations

Where there is no mandatory requirement for EIS, SEIS, VCTs and Business Relief offers or managers to follow the SDRs, that does not leave them entirely without ESG-related disclosure obligations. Far from it.

The Listing Rules (LR), Market Abuse Regulation (MAR), Disclosure Guidance and Transparency Rules (DTR) and Prospectus Regulation (PR) all require potential disclosures regarding climate-related and other ESG matters. For example, under the PR, issuers must consider what disclosures they should make to enable investors to assess (among other things) the assets and prospects of the issuer. Climate-related risks and opportunities are widely understood to be financially material to many issuers' assets and therefore may need to be disclosed[65].

The LR state that a listed company, must take reasonable steps to establish and maintain adequate procedures and controls to enable it to comply with its obligations and such obligations include disclosure requirements, governance rules and the timely and accurate disclosure of information to the market.

You should also note that these rules do not apply to AIM-quoted companies which is where many BR, EIS and VCT-qualifying companies can be found. Nevertheless, all AIM-quoted companies are required to adopt a recognised corporate governance code and disclose annually how they comply with that code, where they departs from their chosen code, and an explanation of the reasons for doing so. Generally, the UK Corporate Governance Code published by the Financial Reporting Council (FRC Code) or the Quoted Company Alliance Corporate Governance Code (QCA Code) are selected by AIM-quoted firms.

The UK Corporate Governance Code is made up of a set of Principles that emphasise the value of good corporate governance to long-term sustainable success and it's widely expected that environmental best practice may be incorporated into the Code in the coming years. The current Principles relating to Board Leadership and Company Purpose include:

A. A successful company is led by an effective and entrepreneurial board, whose role is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society, and;

C. The board should ensure that the necessary resources are in place for the company to meet its objectives and measure performance against them. The board should also establish a framework of prudent and effective controls, which enable risk to be assessed and managed.

Meanwhile, the ten principles of corporate governance in the Quoted Company Alliance Corporate Governance Code, include:

3. Take into account wider stakeholder and social responsibilities and their implications for long-term success.

4. Embed effective risk management, considering both opportunities and threats, throughout the organisation.

All of these principles can and should take into account ESG concerns and prompt appropriate disclosures in annual reporting and corporate governance statements.

What's more, the Companies Act 2006, which applies to all UK companies, places some key ESG responsibilities on the shoulders of directors. This includes the requirement to take into account items such as the 'interests of the company's employees' and 'the impact of the company's operations on the community and environment.' when making company decisions. It is not sufficient for directors to justify their decision-making on economic considerations alone and they must not only consider ESG factors that affect their business today, but also the likelihood of such practices being outlawed, or causing reputational damage, in the future. Insufficient focus here could leave directors exposed to directors duties' claims[66].

As for Premium Listed companies, they must, under the Premium Listing Rules, communicate information to holders and potential holders of their premium listed equity shares in such a way as to avoid the creation or continuation of a false market in those premium listed equity shares[67]. Additionally, a premium-listed issuer is required to include within its financial report a statement of how the company has applied the Principles set out in the UK Corporate Governance Code 2018 which explicitly recognises companies' responsibilities to wider society and provides authoritative guidance on how boards can ensure strategic importance is given to ESG considerations that are critcal to many investors[68].

The Prospectus Regulation Rules, include Recital 54 which states that risk factors should be limited to those risks which are material and specific to the issuer, including environmental, social and governance circumstances which can constitute specific and material risks for the issuer and its securities and, in that case, should be disclosed[69]. Compliance expert Gillian Roche-Saunders of Adempi Associates confirmed that, "VCTs are themselves subject to the Prospectus Regime because they are listed on the main market."

She went on, "Single company BR investments are often structured as PLCs and being a PLC means that they are caught by the Prospectus Regime whether listed or not – in other words there are both public and private PLCs and both need prospectuses. Other BR structures wouldn't typically need a prospectus, and neither do EIS offers. EIS investee companies can be listed on AIM but this doesn't require a prospectus."

It's also important to remember that any firm authorised by the FCA, such as a discretionary fund manager or AIFM, has certain basic obligations that are derived from the FCA's Principles for businesses. They include conducting its business with integrity, due skill, care and diligence, taking reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems and paying due regard to the information needs of its clients, and communicating information to them in a way which is clear, fair and not misleading. The fact that these broad rules do not specifically mention ESG-related activities and disclosure, does not mean that they don't apply in that context.

Thought Leadership

WHAT ESG INFORMATION CAN ADVISERS EXPECT OF EIS, VCT AND BR MANAGERS?

GILLIAN ROCHE-SAUNDERS
PARTNER, ADEMPI ASSOCIATES

As with elsewhere in the market, tax-efficient products are reacting to the increased client demand for ESG or Impact focus in their investment. The FCA has confirmed the first raft of disclosure rules and is getting close to announcing the direction it will take to label products. What will this mean for navigating the tax-efficient product market?

The FCA is introducing new disclosure rules that apply to asset managers and asset owners. The rules look set to capture most but not all tax-efficient products.

In particular, there are plans to stagger implementation even where products fit the mould of products which will ultimately be caught. This could be a case of 'size matters' because the current proposal is that only those managers with more than £5 billion of AUM across their funds and portfolios would be captured initially.

No matter the plans for staggering implementation, there will be EIS, SEIS, VCT and BR managers voluntarily opting in to the regime. Any fund and portfolio managers not caught by the rules will be strongly encouraged by the FCA to comply. You may well see some providers immediately keen to produce the data if they feel strongly about ESG and Impact being a core part of their brand. We found this occurred with the equivalent European regime, Sustainable Finance Disclosures Regulation (SFDR).

There is also generally an anti-greenwashing agenda that the FCA is pursuing. Outside of the SDR, increasingly EIS, SEIS, VCT and BR managers will be required to demonstrate how they are meaningfully delivering any objectives they set out in investment documentation. In doing this, many may decide that the easiest path for disclosing such information is to comply with SDR voluntarily.

Finally, increased demand from investors and advisers, and increased supply by other providers, will likely mean a second wave of providers leaning into the regime, even before they strictly have to.

So if disclosures are required, or a firm opts in, what can you expect to see?

There are two types of disclosure proposed that will need to be produced annually – an entity-level and a product-level disclosure –but not every product will have both. The entity-level disclosure will sit on the firm's website and explain how they take ESG and Impact considerations into account while managing investments. The product level-disclosure will again be available on the website and may also show or be linked to in client communications. It will contain consistent and comparable disclosures about the product in question and will report back on key metrics.

As the rules are currently drafted it seems that both reports will need to be produced by VCT managers and those BR managers who have structured their offering as a MiFID managed portfolio.

EIS Fund managers and BR offerings that are structured as AIFs will need to produce an entity level report only. While both fund structures are AIFs, only listed AIFs trigger the product-level disclosure.

4.4

Financial advisers

In its Greening Finance: A Roadmap to Sustainable Investing policy paper of October 2021, the Treasury mentioned that it was working to ensure that financial advisers, "take sustainability matters into account in their investment advice and understand investors' sustainability preferences to ensure suitability of advice". This was repeated in the following month's FCA Discussion paper DP21/4, Sustainability Disclosure Requirements (SDR) and investment labels.

To date, no further updates have been issued, although in January 2022, while stating that the Greening Finance paper did signal rules for financial advisers, Mark Manning, technical specialist, sustainable finance and stewardship at the FCA added "in many respects ESG is already in scope under existing rules" in needing to act in clients' best interests and collect all relevant information.

It's therefore abundantly clear that financial advisers should already be carefully considering ESG factors in their advice to clients with or without legislation specifically obliging them to do so.

4.5

Broadening the ESG regulatory focus

As we've discussed, there is more to ESG than just environmental issues and the regulator intends to broaden its focus across the ESG spectrum. In its November 2021 Discussion paper DP21/4, Sustainability Disclosure Requirements (SDR) and investment labels, the FCA stated that, "Over time, the SDR will extend disclosure requirements beyond climate change." This is because the FCA sees, a risk of harm if the financial sector responds to rising consumer demand and awareness of ESG issues without a "supportive regulatory foundation and adequate guard-rails[70]."

One area of immediate interest is Diversity and inclusion, with the rationale being that firms that take ESG issues seriously, including having diverse and inclusive cultures, can better meet the needs of consumers and markets, and support greater innovation and competition[71]. The regulator recognises the correlations between diversity and inclusion and positive outcomes in risk management, good conduct, healthy working cultures, and innovation[72].

We as regulators need to make our expectations of firms clearer and to root them in our statutory objectives…We expect to see diversity and inclusion become part of how we regulate and part of how the UK financial sector does business."

BANK OF ENGLAND, FCA, PRUDENTIAL REGULATION AUTHORITY, DP21/1

In April 2022 Policy Statement PS22/3, Diversity and inclusion on company boards and executive management, set positive diversity targets for women and ethnic minorities on the boards of listed companies. Any failure to meet set targets must be accompanied with an explanation as to why. At least 40% of such boards must be made up of women, with at least one woman at senior board level, and at least one board member from a black or ethnic minority group.

In addition, listed entities must disclose in their annual reports a "standardised numerical table on the diversity of their board" and of their executive management, broken down by gender and ethnicity.

The rules apply from 1 April 2022 and will be subject to a review in three years.

Taking into account the feedback to ***Discussion Paper DP21/2, Diversity and inclusion in the financial sector***, the Bank of England, PRA and FCA intend to consult on more detailed proposals followed by a Policy Statement in Q3 2022. The paper notes that, “any future policy proposals should apply to the broadest range of firms” and included in its suggestions are:

- Applying representation targets to a broader range of firms’ boards than is currently the case
- Embedding rules to take diversity and inclusion into account in firms’ succession planning
- Making senior leaders directly accountable for diversity and inclusion in their firms
- Linking progress on diversity and inclusion to remuneration
- Mandatory diversity and inclusion policies in mandatory diversity and inclusion training requirements
- Mandatory disclosure of aggregated diversity data

Suitability

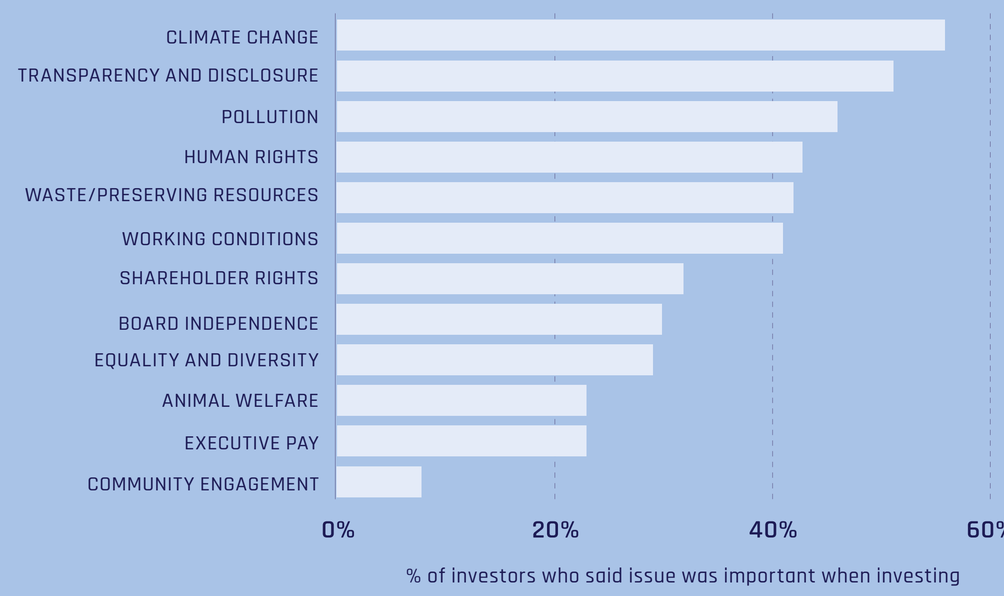
5.1

Exploring ESG with clients

COP26 was a massively visible event in the centre of a three-ring circus of activism, demonstrations and media coverage. That only heightened awareness of the urgent sustainability issues the world currently faces, even if many of those who are now more acutely aware of climate change, have little knowledge of how their money could make a difference. But this doesn’t mean they don’t want it to.

Under these circumstances, uncovering the ESG goals and desires of clients and how they fit within a wealth plan, can be easier said than done. But the naked truth is that these issues are important to many, and they are broad-ranging, with a recent AIC survey finding that, unsurprisingly, climate change is the most important issue across age and gender[73].

IMPORTANCE OF ESG ISSUES TO PRIVATE INVESTORS



SOURCE: AIC / RESEARCH IN FINANCE

Tips for identifying and acting on client ESG interest

1. Be pro-active

Understanding the preferences of clients is crucial to making suitable recommendations. It is critical to ask about ESG during the client fact-find and to raise the subject at client reviews. Director of NextWealth Clive Waller's viewpoint is, *"regulation already exists that demands that advisers match client needs to product, so it's no good putting this on the back burner.[74]"*

2. Simplify terminology

But jargon is definitely not the way to go. James King of King Financial Planning, who surveyed his client base, found that only one in 10 had heard of ESG investing (although half of those who hadn't heard of ESG said it sounded interesting and that they would like to know more)[75].

For vulnerable clients, the importance of clarity is heightened. FCA Guidance on the 'Fair Treatment of Vulnerable Clients' requires firms to:

> Make sure all communications and information about products and services are understandable for consumers in their target market and customer base.
>
> Take vulnerable consumers into account at all stages of the product and service design process, including idea generation, development, testing, launch and review, to make sure products and services meet their needs.

3. Ignore demographic assumptions

Much has been made of differences between how the generations view ESG and how they want, or don't want to engage with it. However, an older person may still have just as much passion for an ESG topic as a younger one. Each client should be treated as an individual; quite simply, demand is not limited to a niche group of clients.

4. Go beyond the binary

We need to move away from a process of asking clients about their ESG preferences in binary yes or no questions in a fact-find[76]. Discussion is crucial as it's not just about the concerns and goals of a client, but also about how they want to address them with their money. This means unearthing whether they are happy for any of their money to be invested in whatever they consider to be sin-stocks, such as oil, because it allows them some stewardship influence, or they want all relevant companies to be screened out, or are happy to invest in oil companies which are already transitioning to renewable energy. And that is just the beginning, the next step is to marry that up with the right investment strategies with the corresponding environmental, social and governance targets.

Advisers should be able to get a sense of investors' desired exclusions, whether that is individual companies or whole sectors. There should also be an understanding of clients' desired positive impact - that might be environmental or social goals. Advisers are already aware that clients' values do much to inform any discussion about their future financial goals and aspirations, so this conversation should help with building a better context in which to place financial advice.

5. Questions to consider

When explaining ESG, it may be useful to refer clients to the UN's 17 Sustainable Development Goals (SDGs) and Principles for Responsible Investment (PRI), for the sorts of concerns that may be relevant:

The UN SDGs are:

- No Poverty
- Zero Hunger
- Good Health & Wellbeing
- Quality Education
- Gender Equality
- Clean Water & Sanitation
- Affordable & Clean Energy
- Decent work & economic growth
- Industry, Innovation & Infrastructure
- Reduce inequalities
- Sustainable cities and communities
- Responsible consumption & production
- Climate Action
- Life below water (protect sea life)
- Life on land (protecting wildlife and eco systems etc.)
- Peace, justice & strong institutions
- Partnerships to achieve these goals

After explaining ESG to clients, it can be helpful to ask a series of questions to gauge how and why they think about it. They might include:

How strongly do you feel about environmental issues when investing your money – factors such as climate change, resource depletion, waste and pollution?

How strongly do you feel about social issues when investing your money – factors such as employee relations, working conditions and human rights more generally?

How strongly do you feel about how a company is run when investing your money – factors such as executive pay and board diversity, political lobbying, bribery and corruption, and the company's tax strategy?

Are there any particular companies, industry sectors or countries that you wish to avoid when investing your money because of ethical concerns, religious beliefs or other values that are important to you[77]?

These could lead on to further discussions including the following:

Do you want to include ESG issues in your investment decisions?

What ESG criteria are most important to you? (Where do your priorities lie?)

Do you want your whole portfolio to reflect your ESG criteria? (You could choose to reflect your ESG concerns in just a portion of your portfolio to start with, then review this decision at a later date)

6. Offer educational material

A paper published by Invesco in June 2021[78] reported that more than a third of investors surveyed would like to know the benefits and drawbacks of sustainable investing and that they would benefit from receiving case studies, along with more articles and guides to sustainable investment. This could give clients much more confidence in discussing the subject matter and understanding what it might be possible for their money to achieve beyond financial goals.

The aims of such education should include establishing that there is now a broad spectrum of sustainable solutions. Of particular importance is an appreciation of the differences between the investment strategies, particularly where complete exclusion of certain investments might or might not apply, why that is the case and what it could mean from both a financial (limiting the investment universe) and ESG (removing possible stewardship power) standpoint.

7. Keep an eye on valuations

ESG investment opportunities are becoming increasingly popular, with much of recent success coming from growth offers. As investor appetite has increased, some valuations have been pushed up, leaving managers of some of the more traditional funds that are pivoting to include ESG considerations, facing more competition to invest into the kinds of early-stage innovators that can offer a real boost to a portfolio[79]. Of course, this is exactly where SEIS, EIS and VCT managers in particular can offer expert insights, access and diversification.

7. Keep a record

Advisers will need to demonstrate that they have taken all of the client's views into account in their recommendations and the portfolios they build. An adviser's suitability report should document exactly how the chosen products met the client's ESG profile.

8. Ensure the conversation is ongoing

The attitudes of clients may shift, making annual reviews essential. Life events can not only change a person's financial situation, but their world view. Hence, having children or suffering a bereavement can have a direct impact on their ESG outlook. A death as a result of a certain disease might fuel interest in pharmaceutical research, or a new baby could spur a new-found interest in education or equality.

9. Investments can change

The policies of investee companies can change too, potentially taking their activities outside of client's suitability requirements - and this might not just be as a result of poor financial performance. If the investee moves into a new activity or country, or adjusts its working practices or policies, it could come into contact with social issues such as child labour in the supply chain, sustainability issues such as excess water usage, or governance issues such as the discovery of corruption and bribery.

Thought Leadership

ESG AND TAX ADVANTAGED INVESTING - A GOOD FIT?

NEIL PEARSON

HEAD OF ESG AND SOCIAL VALUE, MILLS & REEVE

It's increasingly clear that ESG is not a fad – this is now looking more like an irreversible shift in the way we think about, and do, business. But how does it fit within the world of tax-relieved investments? Well, let's look at a few specific features of the risk capital schemes:

Size

The risk capital schemes are focussed on getting investment into SMEs. And there is a perception that ESG only really affects the bigger businesses. However:

- larger companies are starting to select suppliers (including SMEs) that can demonstrate they have an effective ESG strategy
- SMEs' customers will have increasingly high expectations of the businesses they buy from
- SMEs competing with bigger organisations in a tough recruitment market may improve their ability to recruit with a strong ESG strategy

So ESG is just as relevant to the size of businesses that attract EIS and VCT investment as it is to the largest plc.

Trades

Many businesses in the ESG space are carrying on so-called "qualifying trades". And of those, many are developing innovative technology, meaning they are likely to qualify as "knowledge intensive companies", (so can take advantage of the relaxation of the VCT and EIS rules for KICs).

Investors

Only individuals can invest under the risk capital schemes. But individuals are increasingly looking to leave a legacy of some kind - to know that their money has achieved something positive (besides financial returns). This also means that fund managers who focus on ESG as a key investment strategy may well be making their funds more attractive to investors and their advisers.

Exits

A typical EIS/VCT investor is looking towards an exit in three to five years (although most acknowledge that three is very unlikely and even five years is probably optimistic.) There is an increasing amount of evidence showing that ESG creates sustainable longer-term value, and we're already seeing PE houses build ESG into their pricing models. So in three to five years, we might expect ESG strategy to play a key part in achieving a successful exit, as investors will pay more for a business with a strong and credible ESG strategy.

An ESG-focussed investment strategy presents its own challenges to investors and fund managers:

- Fund managers need to ensure they have the expertise to identify good ESG strategy and, post-investment, to monitor and report on progress with ESG
- Investors need to accept that, in the short-term, businesses may incur additional costs on their ESG "journey" in order to help future-proof the business.
- Greenwashing remains a big risk – picking the "genuine" ESG performer will be key, particularly as regulators start to clamp down on managers and businesses that cannot substantiate their ESG credentials

However, notwithstanding those issues, it seems clear that ESG is just as relevant to the world of tax-relieved investments as it is to the wider investment landscape, and that for VCT and EIS investors looking to sustainable businesses with good exit-potential, putting long-term sustainability at the heart of their investment decisions should be a given.

Due Diligence

One of the ESG outcomes the FCA is pursuing is, "that regulated firms have appropriate governance arrangements for more complete and careful consideration of material ESG risks and opportunities[80]."

While the FCA continues on a path towards greater transparency in the ESG space, there is undoubtedly some way to go for regulatory requirements in this area to uncover the most pertinent and helpful disclosures and for their application to the entire market, including all investment managers in tax-advantaged investments.

That doesn't relieve advisers of their duty to undertake reasonable due diligence on the managers and offers that could match their clients' requirements. Speaking in October 2021, Mark Manning, technical specialist for sustainable finance and stewardship at the FCA, said, "advisers must 'do more to scrutinise and challenge' ESG funds."

So it's vital that you create a thorough research and due diligence process on record, so that there is a reasonable rationale for the decisions you have made disregarding or including certain products.

The FCA's Guiding Principles

In July 2021, the regulator published a letter to the chairs of authorised fund managers setting out its expectations on the design, delivery and disclosure of ESG and sustainable investment funds. The letter referenced 'guiding principles', developed by the FCA to ensure that any ESG-related claims are clear and not misleading. The guiding principles are specifically relevant where an FCA authorised investment fund pursues a responsible or sustainable investment strategy and are targeted at funds that make specific ESG-related claims, not those that integrate ESG considerations into mainstream investment processes. Nevertheless, there are pointers to good practice that can be applied more generally where products make ESG-related statements. For such products it is reasonable to expect:

- Specificity regarding any particular real world outcomes investments are looking to target and how their investment policy and strategy are aiming to do so, including the specific ESG investment approach
- Where there are targeted real world outcomes, a measurable non-financial objective alongside the financial objective or strategy with information on how that impact would be measured and monitored. (In practice, since Business Relief and EIS/SEIS are typically discretionary portfolios, this would need to be demonstrated in each underlying investee company which is chosen by the investment manager within any ESG-aligned Business Relief or EIS service)
- Clear rationale linking investments/investment targets with statements made setting expectations for consumers. (The FCA gives an example here of a sustainable investment fund containing two 'high-carbon emissions' energy companies in its top-10 holdings, without providing obvious context or rationale behind it (eg, a stewardship approach that supports companies moving towards an orderly transition to net zero).
- The availability of straightforward information regarding any stewardship strategy, including, where stewardship is part of an active investment strategy, an explanation of how monitoring, engagement and voting activity in respect of ESG/sustainability matters are integrated with investment decisions, and how escalation and divestment decisions are made.
- Initial and ongoing investment information that is easily available and clear, succinct and comprehensible, avoiding the use of jargon and technical terms when everyday words can be used instead[81].
- Ongoing performance reporting on how well a fund is meeting its stated ESG objectives.

6.1

Assessing the product

ESG INVESTMENT APPROACH

Since there is still a variety of terms and definitions in this area, advisers should not simply assume that the name of a fund equates to their understanding, as consistency in the terminology is some way off. Green, ethical, sustainable, responsible, ESG might all be used to badge investment offers, but they can mean different things to different people.

It is essential to understand the ESG investment approach that is applied to fully grasp what underlying investments your clients' capital could be applied to. For example, if your client has strong views on particular sectors they absolutely do not want their money invested in, it may be that a sustainable or integrated ESG investment approach will not work for them. These don't generally explicitly exclude individual investments that might otherwise be appropriate for the portfolio.

Many investment offers in the tax-advantaged space are likely to use some sort of ESG integration strategy by which they consider their existing portfolios and which they apply to future investee companies. Having said that, we are seeing a slowly increasing number of specifically ESG targeted offers with strategies more attuned to sustainable, impact or thematic investing, or a combination of the three. For the most part, these currently sit in the EIS universe.

RATING AGENCIES

It's worth bearing in mind that the nature of ESG has led the FCA to state that there are, "typically more data gaps and assumptions made in producing ESG ratings than, for example, credit ratings[82]." This is because ratings agencies have to work with the information available to them which can be imprecise. Nevertheless, third party reviewers of offerings in SEIS, EIS, VCT, Business Relief such as MICAP are moving fast to help advisers with some of the heavy lifting.

Some investment managers in tax-advantaged offers use third party reporting on their investees: ESG_VC's Measurement Framework focuses on helping early-stage, potential investee companies to understand, measure, and improve their ESG performance. Not only can this inform the investment manager's process of identifying suitable investment opportunities, but, when undertaken regularly, can offer a monitoring tool for the ESG progress of those companies.

USE MORE THAN ONE SOURCE

Having said this, it is a good idea to consult several data sources if advisers want to gain a holistic picture. This eliminates any potential issues around conflicts of interest or bias.

SUBJECTIVITY

It's been said that with ESG due diligence, "you cannot rely on the quantitative side as much as you can with traditional funds[83]." This means that more subjectivity can come into play, including qualitative assessments. Looking at underlying investments - not just some, but all of them - and how they might match or conflict with ESG objectives, as well as end products and services of the investee companies should give you an idea of how the ESG investment approach is applied and help you to align your client recommendations accordingly.

DATA IS STILL IMPORTANT

Don't be afraid to ask for data to back up any claims made about the ESG credentials of investments. If they cannot be provided, it could be a strong indicator the internal governance of the offer is not up to scratch and that perhaps future updates on the ESG impacts it intends to make will be less than satisfactory. Either way, the old adage that 'if it can't be measured, it can't be changed' is particularly apt when it comes to ESG compliance.

VOICE YOUR CONCERNS

If something seems worrying or inconsistent, ask the fund manager yourself. Doing some research beforehand to find evidence of your issue to present to the fund manager is a good idea.

6.2 Assessing the product provider

ETHICAL STANDARDS

How ESG factors are taken into consideration is unique to every manager, but it is not unreasonable to expect a demonstrable commitment to ESG values in its own operations, as well as in the investments it offers. This might be evidenced by documentation on employee diversity and inclusion, employee health and safety, or human rights due diligence throughout the supply chain. Other items to look at could include carbon footprint, and pollution or community engagement.

PRINCIPLES OF GOVERNANCE

The composition of governing bodies (e.g. board of directors), code of ethics, and stakeholder engagement may all give pointers to the level of attention product providers' pay to internal compliance.

STEWARDSHIP AND VOTING RECORD

Question how managers use engagement and proxy votes to encourage ESG best practice within their investee companies.

MEMBERSHIPS, MARKS AND CODES OF CONDUCT

There are numerous codes and standards that firms can sign up to in the ESG space. They include the London Stock Exchange's 'Green Mark' (applies to main markets and AIM) the UN's Principles of Responsible Investment (PRI), the UK Sustainable Investment and Finance Association (UKSIF) and the Global Reporting Initiative, to name just a few. Many firms are very engaged with such organisations with the aim of driving positive change. However, it is important to note that just because a manager has signed up, it does not necessarily mean that it has done much beyond placing the relevant logo on its materials. So ask questions about the rationale for joining, including actual activities undertaken and commitments made.

LOOK FOR EXPERTISE

The FCA expects, "a firm managing a fund that pursues ESG/sustainability characteristics, themes or outcomes to apply appropriate resources to do so[84]." This includes staff skilled and experienced in the ESG/sustainability-specific research, data and analytical tools to identify and monitor relevant investment opportunities. There are professional qualifications in sustainability and, where a manager pursues investments with any kind of specialism, proof of competence in these areas should be requested.

CONSIDER HOW FINANCIAL AND ESG MOTIVES INTERACT

It seems sensible to assume that the more aligned financial and ESG goals are within a firm, the greater commitment there will be from internal stakeholders to the ESG goals. After all, if ESG policies help the financial performance of the company, they are likely to be the subject of genuine focus and effort.

DEALFLOW

While some managers in the tax-advantaged space may have been operating in ESG-adjacent areas for some time, such as renewable energy, others will not. What's more, even where a large part of a portfolio is dedicated to the likes of renewable energy, the manager may have other core investment areas for diversification purposes, which may not previously have been considered with an ESG lens. This makes it important to consider their deal-flow access for these types of investments as, not only will a lack of relevant dealflow impact timelines for the deployment of investors' capital, but it will reduce the chances of seeing enough of the market to get the best deals.

INVESTEE SELECTION PROCESS

While some ESG factors may seem more woolly and undefined than pure financial ones, an important part of establishing ESG goals within an investment should be the setting of clear criteria concerning what matches the investment strategy and mandate and having a process in place to verify that. Some managers have a checklist and rank each company in terms of their ESG criteria, for example.

ENGAGEMENT WITH UNDERLYING INVESTMENTS

It's worth checking what processes are in place to liaise with investees to mitigate ethical risks. This brings into question the monitoring methods of the investment manager, as well as the thresholds it sets for intervening when ESG goals are threatened or not met. Once investment is made, having mechanisms in place to drive the stated ESG agenda as well as the financial one will often be important in reaching and surpassing targeted ESG performance.

6.3

Greenwashing

Doing and recording all of this due diligence work is necessary because of the unfortunate prevalence of greenwashing. The FCA has already publicly admonished ESG and sustainable fund managers in a 'Dear CEO' letter in July 2021, complaining of poorly considered ESG or sustainability focused funds which, "often contain claims that do not bear scrutiny."

The regulator is keen to address concerns about companies giving a flattering picture of their climate policies and business practices in order to cash in on the multitrillion-dollar global market for environment, social and governance targeted funds. The need for confidence in this market twins consumers' investment outcomes with the private finance requirements of the urgent global climate crisis.

Perhaps unsurprisingly then, research by Boring Money[85] indicates that more than two-thirds of advisers are worried about the threat of reputational damage if they recommend 'sustainable' funds that later get accused of greenwashing. And since greenwashing has become synonymous with marketing spin, the social and governance aspects of ESG can face similar challenges.

While standardisation of disclosure practices, definitions and the alignment of global conventions on measuring progress are expected to eventually reduce the risks of greenwashing, in the meantime there are signs that advisers should be aware of and steps they can take to apply their own risk mitigation strategies.

!

What to look out for:

- Lots of buzzwords, without definitions or evidence
- A lack of transparency on ESG targets and how they are to be achieved
- Funds that have been recently rebranded to include ESG-friendly words such as 'sustainable'.
- Opaque reporting on ESG performance

Some questions to ask

1. *How deep is the investment manager's understanding of the various ESG strategies that exist? If they can only describe their own, it begs the question how thoroughly they investigated the options, their various potential risks and rewards, and ultimately their commitment to the market.*
2. *What actions is the investment manager taking internally, outside of its investment offers, to move the needle on ESG issues? This could range from policies to reduce staff travel to reduce carbon emissions to being a B-Corp or engaging with (not simply signing up to – dig a bit deeper to find out what the manager actually does) initiatives like LGBT Great and publishing their diversity and inclusion benchmarking results.*
3. *If an investment acquired for its ESG focus underperforms from an ESG perspective but outperforms from a financial perspective, what specific steps are taken and why?*
4. *Can the investment manager provide examples where ESG factors led to buy or sell decisions? If so, it's likely that ESG considerations have been embedded in the investment process.*
5. *Does the investment manager treat ESG factors in the same manner as other key due diligence items when considering investments?*
6. *What proportion of customer money goes into investments with an ESG focus? For funds with an integrated or sustainable ESG approach, this is very likely to be less than 100%, but it is still worth understanding whether the reality is that minimal ESG focus is being applied in order to understand whether promotional materials make ESG claims that are not proportionate to the overall fund.*
7. *What changes will be made to reflect the rebranding of the fund? (Where applicable) It's particularly worth looking at changes to benchmark, security screening and selection processes[86]. This market repositioning does not always equate to greater ESG focus. "From our research, some funds without any ESG branding show better ESG integration than others specifically marketed as such," says Louisiana Salge, senior sustainability specialist at EQ Investors[87].*
8. *What research does the manager do into the current and potential supply chain of possible investee companies and how much control do they have over it? A fund which purports to have human rights goals should not be finding out after investment that an investee has child labour in its supply chain.*

Thought Leadership

ESG: WHY LABEL?

JULIA DREBLOW

DIRECTOR SRI SERVICES, FOUNDER FUND ECOMARKET

Estimates of the size of the ESG / sustainable investment market vary because strategies vary, but as an 'order of magnitude', last year's Global Sustainable Investment Alliance (GSIA) report estimated global ESG assets were around $35 trillion and Bloomberg has predicted that the area may top $53 trillion, one third of all assets, by 2025.

Yet it is not all plain sailing. The area originally intended to meet the needs of clients who understand and care about the realities of investing in a finite planet, is now too often promoted with largely indecipherable data and metrics, leaving clients confused - and environmental and social problems unsolved.

The FCA has now stepped in for two main reasons: to help make the government's climate commitments achievable and to address greenwash (the exaggeration of green credentials for financial gain).

There was much activity last year, but in the footsteps of the FCAs 'Dear Chair' letter in July, their recent discussion paper 'Sustainability Disclosure Requirements (SDR) and investment labels' (DP21/4) really started the ball rolling.

The lengthy chain between 'real world' investee companies and end investors makes this difficult, but we do now know the focus will be on improved disclosures and client friendly labels.

Making these work won't be easy. Think active vs passive, divestment vs engagement, forward looking vs backward looking data/metrics - and overlay these with the complexity of investing in larger businesses (with both ESG strengths and weaknesses), the rarity of truly black and white choices - and the fact clients and fund managers both have diverse opinions. But it is not impossible either.

The EU has done much work in this area. The way their 'Articles 6, 8 & 9' classifications (which were not designed to be client facing) are now used has fuelled enthusiasm for developing client-friendly labels. SRI Services has been grouping similar ESG and sustainable funds into what we call 'SRI Styles' for over a decade with similar goals.

So where next? The focus must be on both ensuring clients know what funds do and articulating intended real world impacts – whether they be stewardship or stock selection-related. This may be a tall order for passives and data led strategies if they can not sell assets or demonstrate engagement success.

Our industry has a big mountain to climb if we are to integrate issues like climate change, nature loss and inequality into business processes effectively - and lose the sugar coating.

Labels won't be a magic wand. But coupled with improved client-friendly disclosures - and given the phenomenal rate of growth of this area - they could help make urgently needed transitions, like hitting net zero, much more easily achievable.

Julia serves on the new FCA Disclosures and Labels Advisory Group (DLAG) and the BSI fund PAS 7342 Steering Group.

6.4

Passive vs Active

Active investing requires a hands-on approach, typically by a portfolio manager seeking to beat the stock market's average returns, with stock-picking and buying and selling, to take advantage of short-term fluctuations. Passive investors, of course, tend towards a buy-and-hold mentality, with much reduced dealing costs, looking simply to benefit from natural upswings over time.

But these two strategies don't necessarily have to be an either/or choice and combining the two is possible. In fact, objectives of SEIS, EIS and VCT very much require such a combination. This is because investment managers are required to specifically target smaller, innovative companies that could not only beat the market, but blow it out of the water. Yet, the statutory minimum holding periods and exit logic that brings the best growth premia, mean that an investment horizon of five to 10 years is likely.

For EIS and SEIS investments, it is the individual investor that owns the shares in each company selected by the investment manager, and, in order to retain the tax reliefs offered under the schemes, the investor must not sell those shares for at least three years after acquisition. Consequently, if an ESG issue comes to light in an investee company during that period, divesting would lead to the clawback of tax reliefs given by HMRC.

That does not mean that SEIS and EIS managers simply stop monitoring their investees in this period. In fact, it incentivises them to monitor and identify any issues that could lead to either economic or ESG failure (where ESG concerns are part of the investment objectives), with a view to working with the investee to resolve them. Such monitoring is also designed to ensure that the investee does not stray into activities that lead to its disqualification from eligibility for the schemes.

For VCT and Business Relief investments, the investment managers engage in the same kind of monitoring. However, they benefit from a little more flexibility if divestment becomes the preferred method to deal with serious issues. Where VCTs are concerned, this is because investors hold shares in the VCT rather than the underlying investments, and the VCT may chop and change its underlying investments without impacting the holding period of its investors. In the case of Business Relief, while, like EIS and SEIS, it is the individual investor that owns the shares in each company selected by the investment manager, the rules of the relief allow investors to dispose of the BR-qualifying shares and immediately qualify for the relief again, without having to restart the two-year qualifying period, if they reinvest the proceeds in BR qualifying shares within three years. Nevertheless, if the investor dies while not holding any BR-qualifying shares, they will not qualify for Business Relief.

When it comes to ESG, there is scepticism over the utility of passive options. The AIC's research has found that, "advisers are still not wholly convinced by the idea of passive funds for ESG. A majority (62%) agreed that ESG investing is better suited to active funds, and less than half (42%) agreed that ESG investing could be achieved through passive funds. DFMs strongly prefer active options, with 80% agreeing that ESG investing is better suited to active funds[88]."

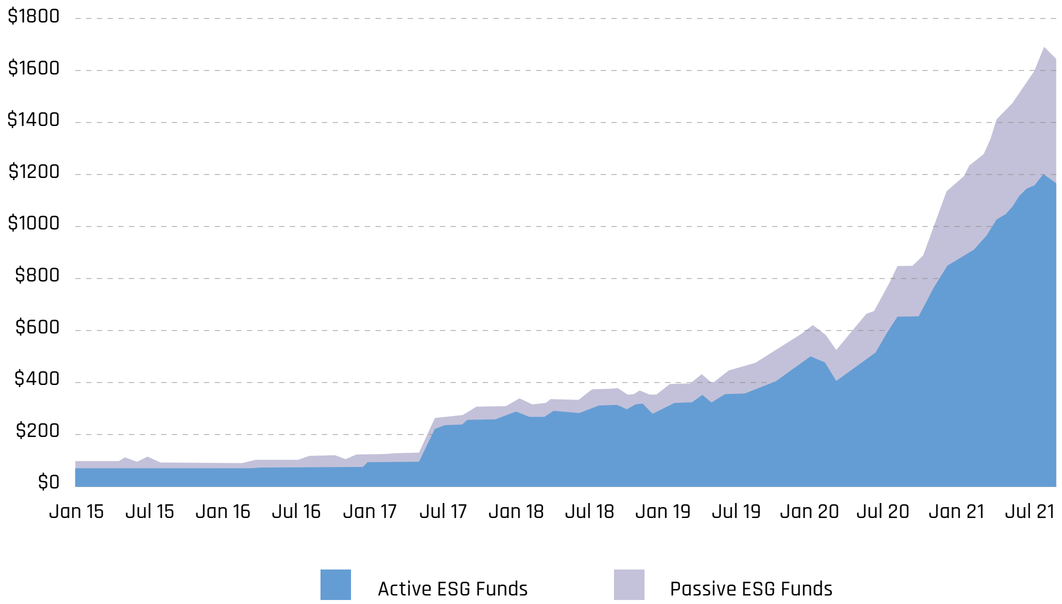
Some of the arguments why ESG investing is only possible with active management include the absence of well-established, easily verifiable ESG indices (although this is evolving quickly) and the need to actively assess portfolio suitability over the long term, whereas many passive strategies are retrospective and only reviewed annually[89].

However, the UNPRI has stated that "passive strategies can incorporate ESG factors[90]" although it can be difficult for an investor to find an off-the-shelf responsible investment index that matches their policies and strategies. Consequently, some create custom benchmarks, either internally or through service providers, to incorporate their specific ESG criteria. However, those looking to invest in tax-advantaged offers should remember that, shares listed on a recognised stock exchange, for example the main markets of the London Stock Exchange (LSE), are not eligible for SEIS, EIS, VCT and BR tax reliefs. Shares quoted on AIM, the LSE's secondary market are.

Passive ESG funds invest in line with an index constructed using ESG ratings, this is akin to hiring someone after reading their CV alone. Active ESG funds go beyond looking only at the rating by conducting additional research, meeting management, and reviewing other relevant data points before investing.

REBECCA CRADDOCK-TAYLOR, DIRECTOR OF SUSTAINABLE INVESTMENT, GRESHAM HOUSE

ASSETS UNDER MANAGEMENT IN GLOBAL ESG EQUITY FUNDS



SOURCE: EPFR INFORMA FINANCIAL INTELLIGENCE, BOFA US EQUITY & QUANT STRATEGY, 21 OCTOBER 2021

Practical Tips

7.1

Building your firm's ESG proposition from the inside out

Since ESG involves more than just spreadsheets and monetary returns, it can seem a daunting task to begin to place a greater focus on non-financial sustainability issues. But there are some practical steps that can help you get started and which offer business benefits from raising staff morale and demonstrating the positive development of your company culture, to attracting and retaining the best staff, and raising your company profile.

Find your ESG Champion

This could be the CEO, owner or another person in the business. They don't have to be in senior management but they do need top level down commitment on ESG. They also need to have a genuine interest in this area and ideally a passion for making a difference. That person can then be the focus of ESG activity and changes within the firm and take ownership of its development. In larger firms, this could build into an ESG champions network, reporting into a leadership team such as an ESG Committee.

The tasks of ESG champions should include ensuring the firm stays up to date on all the latest information and issues. One way to do this is to sign up for updates and newsletters. They could include the FCA's news and publications email alerts for upcoming regulatory concerns and requirements.

There are plenty of improvements that ESG champions can engage with and many are quick, easy and cheap to implement. They might start with improving the energy efficiency of your workplace by installing a smart meter, or reducing business travel - could an online chat achieve the same results? A simple checklist like this one can be a useful tool in the ESG champion's tool kit.

Environmental checklist

GREENING THE OFFICE

- Switch to a renewable energy tariff ✓
- Install LED lights and motion sensors ✓
- Encourage switching off electrics when not in use ✓
- Upgrade to energy efficient models ✓
- Replace desktops with more energy efficient laptops ✓
- Install own renewable technologies such as solar panels ✓
- Ensure workplace is properly insulated and thermostats set correctly ✓

SUPPLIERS

- Use eco-options in marketing materials such as recycled paper ✓
- Use catering suppliers that limit packaging use and consider vegan and vegetarian-only ✓
- Partner with businesses with recognised environmental credentials ✓

WORKING FROM HOME

- Encourage home working environmental practices through targeted campaigns ✓

TRAVEL

- Encourage car pooling through a car share scheme ✓
- Sign up to a cycle to work scheme (and offer changing and showering facilities, and bike parking space) ✓
- Subsidise public transport season tickets and travel passes ✓
- Install Electric Vehicle charge points ✓

REDUCE, REUSE, RECYCLE

- Go paperless as much as possible ✓
- Set printer default to double-sided and black and white ✓
- Utilise digital options such as note-taking apps and video technology ✓
- Offer easier and more convenient recycling facilities
- Offer composting option for food waste, tea bags and coffee grounds ✓

Keep learning

There is training, education and support available and you don't necessarily need to reinvent the wheel. But the FCA has warned against 'competence-washing' and the need to, "promote genuine capability-building across the financial sector, including through functional training",as well as, "general staff training on climate change and net zero, and ESG more broadly[91]."

What's more, the evidence of your engagement by way of memberships and certificates is a good way to show both internal and external stakeholders that your firm takes these responsibilities seriously.

The Principles for Responsible Investment (PRI) has an online academy that is a good place to start looking for courses which are online, easily accessible and cost effective.

Depending on the size of advisory firm, why not consider becoming a member of the Climate Financial Risk Forum (CFRF), which is co-chaired by the FCA and the Prudential Regulation Authority (PRA), and builds capacity and shares best practice across financial regulators and industry, to advance our sector's responses to the financial risks from climate change[92]. Or sign up to the Good Business Charter, a simple accreditation which organisations in the UK can sign up to in recognition of responsible business practices in any sized private or public organisation. An organisation must meet all 10 commitments to receive the accreditation, with a focus on a real living wage, fairer hours and contracts, employee well-being, employee representation, diversity and inclusion, environmental responsibility, paying fair tax, commitment to customers, ethical sourcing, and prompt payment.

Another option is to become a member of the UK Social Investment Forum which aims to build a better social investment market in the UK and offers, among other things, practical collaboration opportunities and ideas to improve effectiveness and a space to share information. The path to becoming a B-Corp (companies verified by B Lab to meet high standards of social and environmental performance, transparency and accountability) is also full of learning opportunities. Meanwhile, signing up to the Women in Finance charter, a pledge to support the progression of women into senior roles in the financial services sector, is a clear indication of a firm's views on gender diversity and inclusion.

Diversify your workforce

Some entities, like the Bank of England, have adjusted their recruitment practices so that hiring managers are only presented with data relevant to the job application, without names or dates giving away age or ethnicity. Other options include putting in place a programme with the aim of attracting and supporting female professionals returning to the workforce after a career break, often in partnership with Women Returners. This can be enhanced by changing employee benefits such as shared parental leave, job shares, and flexible working hours[93].

Programmes designed to help broaden the mix of employees include 100BlackInterns which encourages financial firms to employ at least one black intern, the Race at Work Charter, which offers toolkits on progressing many diversity issues, including age-inclusive employment, and the Valuable 500, a global business collective made up of 500 CEOs and their companies, innovating together for disability inclusion.

Meanwhile, mentoring schemes and employee-led networks can work collaboratively to offer lived experience insights, subject matter expertise, and a platform for engagement, which can help staff to feel heard and seen and to climb the corporate ladder. This is important as the Harvard Business Review has found that, "what matters is how an organization harnesses diversity". So work on building trust by creating a workplace where everyone feels valued and safe to express themselves freely.

Here, communication is key, with modeling of behaviours and shared norms an important factor. Clear messages and communication, particularly around conduct are vital – whereas a lack of transparency is identified as one of the red flags that indicate a poor corporate culture. Instead, give employees a voice - If there is a forum for them to give their feedback and a response to it, it is a powerful indicator that they, and their input, are valued.

investors increasingly want to understand information about...one of the most critical components of companies, their workforce.

GARY GENSLER, CHAIR OF THE US SECURITIES AND EXCHANGE COMMISSION (SEC)

Advance social goals with charity engagement

Opportunities for a sense of achievement beyond work are a good way to help build the self-worth of staff members. For example, volunteering programmes that link up with local charities may be hugely beneficial to local communities. Beyond those positives, such initiatives from financial services firms also have the potential to not only demonstrate the firm's social responsibility, but also to address some of the practical problems facing the sector; consider a financial advisory firm whose staff regularly visit the local sixth form college to talk about the benefits of working in the financial services industry. Or a firm that uses its business skill sets by offering free sessions on how to put together presentations, writing CVs, or managing a business to encourage and empower the next generation of professionals.

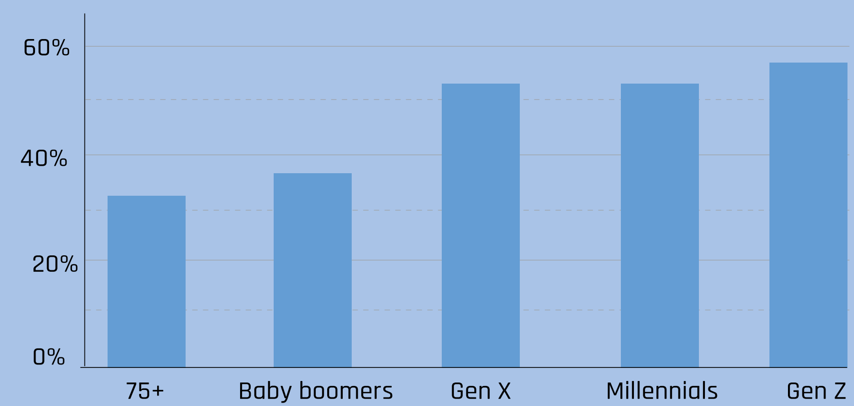
How ESG and intergenerational issues interect

There is now a groundswell of interest in environmental, social and governance issues among all generations. But, there is no denying that the profile of these concerns has been raised very much by millennials (born between 1981 and 1996) and generation Z (born between 1997 and 2012), into which age group Greta Thunberg, at just 19, falls.

A key part of the work of financial advisers is now to speak across the generations. With families more complex than ever thanks to an ongoing divorce rate of over four in 10, growing numbers of blended families (the fastest growing type of household over the last two decades, according to the Office of National Statistics), and increasing life expectancy, this is no mean feat. And it brings with it a need to understand the needs and desires of multiple generations, especially considering parents and step parents could have children falling into different generational groups and it's now perfectly possible for four, or even five family generations to be alive at the same time.

It can be helpful to look at the various generational groups and their changing life experiences across different periods in history to understand how and why ESG issues resonate with them. Given the massive importance of intergenerational wealth transfer as an opportunity to develop new relationships with the next generation as a way to offset ageing client banks, combined with the increasingly significant role of financial advice in our collective, sustainable futures, this could be a particularly useful focus area:

GENERATIONAL DESIRE FOR SUSTAINABLE INVESTING SINCE COVID-19



SOURCE: M&G WEALTH, FAMILY WEALTH UNLOCKED REPORT 2022

Baby Boomers: 1946-1964

Baby boomers grew up in the post-war boom environment with the substantial benefits of free education and cheap housing. One in 5 baby boomers in the UK is now a millionaire and the IFA industry has been geared to serving their affluence. They are concerned with helping their children, but also spending money on consumables like cars and holidays.

Generation X: 1965-1980

Those in this category are fewer in number as a result of the trend for women to have less children, starting in the 1960s. As a result, they have less consumer power than the Baby Boomers. Generation X is the generation in which the number of women going to university climbed significantly so that female undergraduates started to outnumber men. This is also the time when work-life balance discussions begin as many more women enter professions. This age group saw the UK transition from mainly white to multi-cultural. Gen x'ers are squeezed financially with concerns around not only helping their children (the average age at which children leave home is now 29), but also their ageing parents.

Millennials: 1981-1996

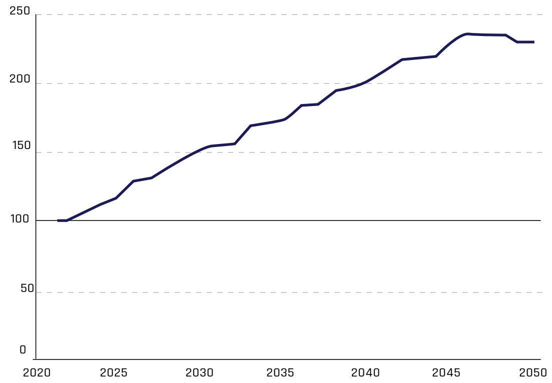
This is the best educated generation in history - 50% globally have a first degree and 32% have a second degree. Tech, travel and eating out became cheap as they entered adulthood. Healthcare, childcare, education (tuition fees) and housing have become expensive. So, they have greater access to experience purchases rather than traditional assets. Since the majority of millennials are in dual income households, they do have some disposable income, but most are now in their thirties with children being their main focus.

Generation Z: 1997-2012

They have little or no memory of the 20th century and since 2008 have grown up in the deepest recession since world war two, with huge upheavals, including Brexit, and the Covid-19 pandemic. Those in generation Z have had smart phones since childhood and lived their adolescence on social media. As a result there is no question to them that their voices and causes are important and deserve attention. Consequently, they are more politicsed than millenials and more prone to activism. They have instant access to what's going on globally and feel entitled to change it quickly, while any-time, any-place avenues to the world's markets have created the sort of entrepreneurs who are capable of driving the shift. In this way, technology has exacerbated the generation gap and also shaped the generation Z definition of luxury service: Not tech, but face to face communication, because it is rare.

Importantly, millennials are increasingly becoming the next generation of clients for financial advisers as a huge transfer of wealth is underway. They are the largest-ever generation globally, so have commanding consumer power that will only increase as they amass more wealth. In fact, by 2030, millennials are expected to control over $20 trillion of assets globally. In the next decade alone £327 billion is set to transfer to 300,000 millennials from baby boomers in the UK[94].

THE VALUE OF INTERGENERATIONAL TRANSFERS IS SET TO DOUBLE BY 2040



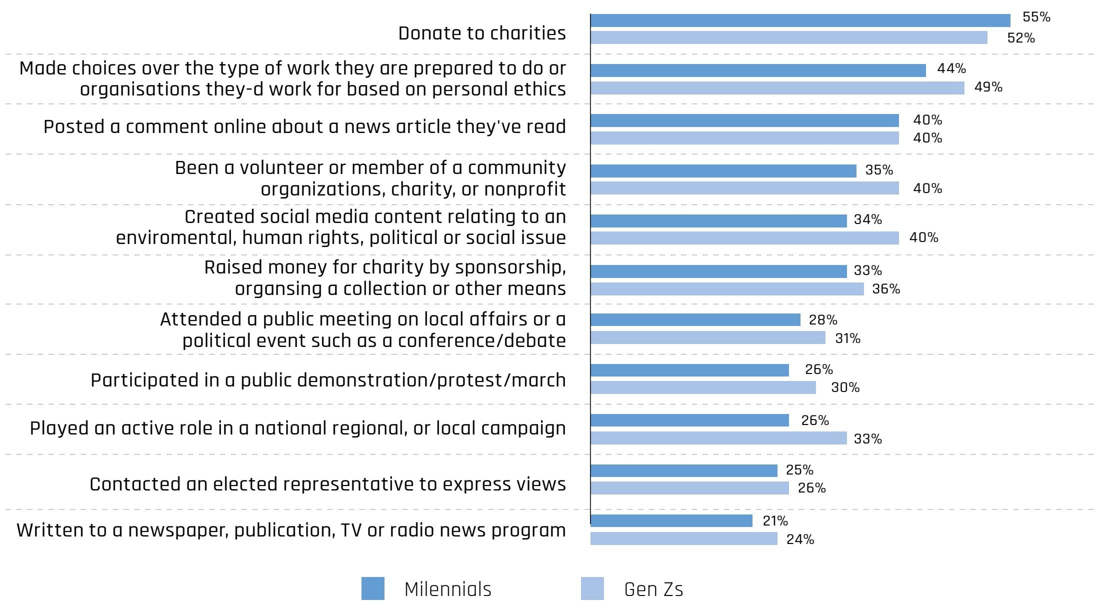
Index of total expected future bequests of adults aged over 50 by estimated year of bequested (2021=100): England

SOURCE: THE RESOLUTION FOUNDATION

Their ESG investing demands are different to older generations. Unlike generation Z, their concerns are more likely to be for their young children, and while there is definitely urgency, there may be more caution and patience with the types of sustainability results they are seeking. The fact they are older and more experienced than generation Z supports this thesis, although the Covid emergency has been transformative to every generation's view on how quickly change can be achieved when there is little alternative.

With a greater willingness to consider different ways of living driven by the high cost of the norm and the high value of experiences, millennials are ready for change. They brought us the sharing economy, exemplified by the 'Airbnb' sharing-rather-than-owning approach and they are perhaps the first generation that will invest, en masse, for a purpose. The weight of their consumer power is already forging an investing path for older and younger people to follow. If generation Z has been the voice of ESG, millennials are bringing individual wealth to the table.

% THAT HAVE DONE THE FOLLOWING OVER THE PAST TWO YEARS



But input beyond just those born after 1980 is required: “We cannot simply stand back and say: ‘This is a younger person’s problem.’ This is an intergenerational challenge with massive consequences for us all.[95]” So said John Elkington, business adviser and one of the founders of the global sustainability movement.

One issue that has been uniting people of all ages in the pandemic and post-pandemic age is the importance of community and this should not be underestimated. There is now a tangible sense of individuals having a greater sense of responsibility to their community and recognition of how the actions of one can impact the many. The expectation is that this will increasingly play out in what people invest in.

There are though, still varying viewpoints. Royal London has found a significant age divide where pension investment is concerned, with more 18-34-year-olds (66%) willing to invest their pension responsibly than those aged 55+ (40%)[96]. In Saltus’ research the reason for this becomes evident - just 11% of under-25s cited insufficient returns as the reason they don’t invest in ESG funds, whereas a third of people aged over 55 gave this answer. To some extent, that is understandable given how much closer to retirement over 55s are and the attendant concerns about ‘non-traditional’ investment returns.

Baby boomers and generation X have grown up investing in traditional portfolios that have worked well for them over the long term and have made money from industries that rely directly or indirectly on fossil fuels. “Psychologically, older people may be afraid of change, particularly if they have held a long-term portfolio and enjoyed good, historical returns,” says Foster Denovo financial adviser, Jamie Smith[97]. But this fear of change could potentially be reversed if investment managers can cut through the jargon and demonstrate the benefits of ESG, including potentially lower risk and higher returns. A lack of interest or understanding of ESG is not the same as a negative attitude towards it.

These statistics reveal that there are absolutely perceived obstacles to ESG investing that apply across different generations at differing levels that advisers may well be able to address. Bearing in mind the development of ESG disclosures and the weight of positive evidence regarding ESG investment performance, there is scope for re-education to address some of the generational imbalances in ESG investing.

In fact, all of the generations need education on ESG - even generation Z: Leslie Gent, managing director and head of responsible investing at the private bank Coutts says that, “Younger people can be very impatient for change and while many [family] portfolios have already been significantly cleansed as a direct result of their influence, the conversations we continue to have with them can become emotive.” She goes on, “While the debate around ESG inevitably starts off with them wanting to make particular exclusions from a portfolio, it’s our job to explain to all members of the family that if you limit your investable universe, there will be impacts on your returns[98].”

It does seem that investors are learning, though, with EQ’s 2021 Shareholder Voice survey revealing that a growing number of younger people are recognising the effectiveness of stewardship as one means of expressing their ESG concerns within investments. The survey suggests that just under 70% of all shareholders in the UK and US are below 40 years of age and that 80% of generation Z shareholders have already voted in AGMs — the highest of any generation[99].

While those in generation X may still be waiting for a financial windfall when their parents die, those in generation Z look on

inheritance as being more about what kind of world they will inherit. Consequently, advisers need to recognise ESG is not just something they are going to indulge in when they have the money, but something that is crucial to their identity. What’s more, generation Z is accustomed to instant interaction, speedy gratification and the ideology of individuality (take a look at TikTok). That means services and products now need to be more customised, tailored to individual preferences, priorities and values. And members of generation Z also want more involvement in the process of creating the solutions they need.

Older clients, baby boomers in particular, and to a lesser extent, those in generation X, arguably have less awareness of the interconnectedness of sustainability and social issues. Having not grown up with instant information at their fingertips, they may have social goals with little or no appreciation of how child labour practices on the other side of the world, for example, can be influenced for better or for worse through UK-based investments.

In fact, some in financial advisory businesses have identified that younger women in particular are noticeably more vocal about social inequality than men. This is borne out by an AIC survey which asked a diverse group of investors how they ranked ESG issues on a scale of one to five. Women ranked social issues at 3.5 on average and men at 3.1[100].

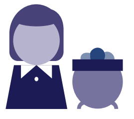
This gender split is an interesting observation and becomes even more illuminating in the context of future wealth distribution: By 2025, 60% of the UK’s private wealth will be in female hands (mainly via inheritance from a deceased spouse)[101]. Not only does this point to increased engagement from baby boomers and generation X on investments with a social interest element, but It is a good reminder that diversifying client banks away from the predominance of males aged over 50 is a sensible option.

It appears though, that there is a growing acknowledgement among advisers that their clients are not just a homogenous group, at least where age is concerned. While the introduction of PROD rules in 2018 has led to more advisers segmenting their clients to ensure suitable strategies are in place for the most relevant products and services, 2021 saw a doubling of the proportion achieving this segmentation according to client life stage, rather than AUM[102].

Of course, every adviser knows that each client is individual and their circumstances, goals and needs differ. But one thing is certain, financial advisers can be a vital conduit between different generations and a trusted adviser for all age groups. And when it comes to ESG, while many of the products and services available may be useful to a range of client age groups, the way those age groups think about ESG and their drivers for doing so, could be very different. This will very likely have a role to play in how an adviser approaches the topic and their understanding of the ESG goals the client is aiming to fulfill.

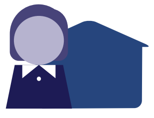
> ***The future of wealth and influence lies with grandma… in the short term at least.***
>
> **DR ELIZA FILBY**

Baby Boomer Women: The New Age of Old Age



By 2025 60% of the UK's private wealth will be in female hands (chiefly through inherited wealth from a deceased spouse)

Women make up 80% of landlords



Case studies

CASE STUDY 1

IHT PLANNING WITH AN ENVIRONMENTAL FOCUS

SCENARIO:

Mrs Brown is a 78 year old widow with two grown up children and four grandchildren. She has an estate worth £2.1million and wishes to leave as much as possible to her family, especially her grandchildren, but wishes to retain control of her capital. Her grandchildren are worried about climate change and concerned about what they can do as a family to help.

Mrs Brown's Estate

£750k

INVESTMENT

£1million

£150k

ISA

£200k

TOTAL ESTATE VALUE

£2.1 MILLION

four grandchildren concerned about climate change

£400,000

Mrs Brown invests into Business Relief portfolio with a renewable energy focus to address her grandchildren's concerns

3-4% p.a growth

2 YEARS

The £400,000 of shares fall out of charge to IHT (saving at least £160,000 in IHT)

BR

Mrs Brown changes her will to leave the BR shares to her granchildren

But BR does not remove the value of the shares from Mrs Brown's estate. However, before she dies, she gives £100,000 to friends of the Earth, meaning the residence Nil rate band taper no longer applies allowing her access to £350,000 IHT relief (her allowance and her deceased husband's) as she is leaving her house to her children.

CASE STUDY 2

PLANNING FOR LATER LIFE INCOME WITH A SOCIAL AND GOVERNANCE FOCUS

SCENARIO:

Ms Khan is a 53 year old CIO with a successful tech company. On her current trajectory she will reach her pension lifetime allowance in the next couple of years so is now looking at alternative investments to supplement her pension when she retires. Ms Khan is divorced with no children but is very close to her niece and nephew, who are teenagers.

Ms Khan fought hard to overcome stereotypes that an Asian woman could not have a successful career in tech

But her local community and women's business network, and her own hard work helped her to her current role.

She wants to travel widely when she retires but also wants to promote diversity and inclusion by investing in companies developing fair-priced tech to everyone and which strive for equality

Adviser recommends

VCT Investment

Offers tax free dividends to complement her pension

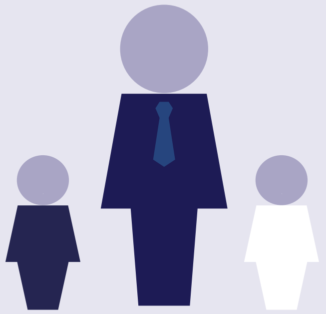
She selects a VCT that focuses on tech companies producing disruptive tech including strong governance and policies on diversity and inclusion

CASE STUDY 3

TAX-EFFICIENT WEALTH ACCUMULATION AND PAYING IT FORWARD

SCENARIO:

Mr lucas is a 48 year-old entrepreneur with children aged 10 and 7. He is the founder of several early stage companies one of which is experiencing rapid growth. He wants to harness that for his children that for his children as well as do the right thing to give them and others the same exciting opportunities he has had to bring his ideas to fruition.



Mr Lucas speaks with his financial adviser who suggests that he invests in an EIS portfolio to diversify his current holdings

EIS OFFERS TAX-FREE GROWTH

AND

2 YR

AFTER 2 YEARS, THE SHARES QUALIFY FOR BUSINESS RELIEF AND 100% IHT EXEMPTION

EIS

HE SELECTS AN EIS FUND THAT HAS A STRONG PIPELINE OF INVESTMENTS IN COMPANIES LOOKING TO DEVELOP ENTREPRENEURIAL SKILLS IN YOUNG PEOPLE AND TO SUPPORT DIVERSITY SPIN-OUTS

CASE STUDY 4

ESTATE PLANNING, LIQUIDITY AND DOING THE RIGHT THING

SCENARIO:

Mr Baron is 70 and keen to make his money continue to work hard for him. He has one son who is very wealthy through a successful business who says he doesn't care what his father does with his money as long as it doesn't harm the planet and is good for business!

His grandson is passionate about Brazil and wants to set up an eco-travel business there.

Mr Baron speaks with his financial adviser. He wants to retain access to his money so he doesn't have to ask his son for money if he needs it quickly like his parent when they suddenly had costly care needs.

The adviser recommends an AIM BR investment

It offers rapid access through the liquidity of a public market and growth.

He selects a provider which is aligned to the UN Sustainable Development Goals

2 YR

After 2 years, the investment qualifies for BR and becomes 100% IHT exempt. So Mr Baron knows his grandson will get a cash injection for his business when Mr Baron dies

Appendix

Appendix

10.1

Glossary

Active ownership: A form of stewardship whereby shareholder power is used to influence corporate behaviour through direct corporate engagement, filing or co-filing shareholder proposals, and proxy voting guided by comprehensive Environmental Social Governance (ESG) guidelines.

Best in class: Investments in sectors, companies or projects selected for positive ESG performance relative to industry peers, and that achieve a rating above a defined threshold. Also known as positive screening.

Carbon footprint: A measure of the total amount of greenhouse gasses – primarily carbon dioxide – released into the atmosphere as a result of the activities of an individual, company or other entity.

Carbon neutrality: Having a net zero carbon footprint (no net release of carbon dioxide or other greenhouse gases into the atmosphere) through carbon offsetting or eliminating carbon emissions altogether

Carbon offsetting: Removing or offsetting an amount of carbon omitted by a certain activity. This can be through the purchase of carbon credits or through other actions such as planting trees.

Carbon pricing: The cost applied to carbon pollution in order to encourage polluters to lower the amount of greenhouse gases they emit into the atmosphere. This cost may be levied in the form of a carbon tax or through the requirement to purchase a permit through the 'cap-and trade' system.

Clean energy: Energy that is from a non-polluting source, such as solar, wind and wave power

Climate change: The change of climate which is attributed directly or indirectly to human activity that alters the composition of the global atmosphere and which is in addition to natural climate variability observed over comparable time periods.

Climate risks: Risks linked to climate change that have the potential to affect companies, industries and wider economies. As well as physical risks, these include potential regulatory action, litigation and competitive and reputational risks that can be associated with climate change.

Corporate engagement: Using shareholder power to influence corporate behaviour through direct engagement with a company.

Corporate governance: The rules, practices, and processes used to direct and manage a company. The main force influencing corporate governance is a company's board of directors, although the board can be influenced by, for example, shareholders, creditors, customers and suppliers.

Divestment: The selling of shares in companies based on ESG concerns. This is often considered the ultimate shareholder sanction if a company's management fails to respond to other pressures to improve its ESG credentials (such as engagement)

Environmental factors: The environmental issues considered by responsible investors when analysing investments. Examples include climate change, resource depletion, waste, pollution and deforestation.

Environmental, Social and Governance (ESG): the three central factors/criteria used by responsible investors to screen and select companies and other investments for their portfolios. Sometimes E and S are substituted for Ethical and Sustainable.

ESG integration: The systematic and explicit inclusion of material ESG factors into investment analysis and investment decisions. ESG integration alone does not prohibit any investments. Such strategies could invest in any business, sector or geography as long as the ESG risks of such investments are identified and taken into account.

Ethical investing: An investment approach that excludes investments on the basis of ethical, values-based or religious criteria, for example, gambling, alcohol, or armaments (also known as the sin stocks)

Exclusions: Exclusions prohibit certain investments from a firm, fund or portfolio. They may be applied on a variety of issues, including to align with client expectations, and at different levels (sector; business activity, products or revenue stream; company; jurisdictions/countries).

Governance factors: The corporate governance issues considered by responsible investors when analysing investments. For example, a company may be assessed on its policies/approach to bribery and corruption, executive pay, board diversity and structure, political lobbying/ donations and tax strategy.

Green investing: An approach that considers investments based on their environmental credentials.

Greenwashing: Misleading or exaggerated sustainability claims made by firms

Impact investing: Investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return. Examples include social bond funds, private impact investing and SDG impact funds.

Negative screening: An approach which specifically excludes companies based on their involvement in undesirable activities.

Net Zero emissions: Sometimes known as Net Zero Carbon or just Net Zero, this describes a state where any CO2 and Greenhouse Gas (GHG) emissions left over after decarbonisation are offset by negative emissions of an equivalent amount of CO2 from the atmosphere, resulting in no net GHG impact. The offsets need to actively remove carbon dioxide from the atmosphere, as opposed to only avoiding emissions elsewhere which is allowed in the specification for carbon neutral. There is not yet an agreed standard on what constitutes Net Zero Carbon for an organisation, product, or country, although there are multiple organisations with working definitions, for example, the Science Based Targets Initiative

Norms-based exclusions: An approach that excludes investments on the basis of not complying with international standards of conduct, for example, the UN Human Rights Declaration.

Paris Agreement: The international treaty that came into force in November 2016. The agreement is to limit the global rise in temperature from pre-industrial levels to below 2°C this century and ideally below 1.5°C.

Positive tilt: A 'sustainability focus' investment approach where overweight positions are taken in stocks if they fulfil certain sustainability criteria and/or deliver on a specific and measurable sustainability outcome(s), relative to a benchmark (for example, half the carbon intensity of the benchmark).

Positive screening: An approach which specifically filters companies based on their involvement in beneficial activities.

Principles for Responsible Investment (PRI): A UN-supported body regarded as the world's leading proponent of responsible investment. It encourages investors to use responsible investment to enhance returns and better manage risks. It has issued a set of voluntary and aspirational investment principles that all signatories must commit to.

Renewable energy: Energy from a source that is not depleted, such as solar, wind and wave power.

Responsible investing: Commonly used to describe a range of ESG investing strategies, such as ethical, exclusionary, impact, socially-responsible investing and ESG integration.

Screening: An approach which specifically filters companies based on their involvement in either beneficial (positive) or undesirable (negative) activities.

SDG impact funds: Funds where impact is measured against the UN Sustainable Development Goals (SDGs). This can be achieved, for example, through listed equities, a social bond fund or private impact investing.

Shareholder advocacy: A form of stewardship whereby shareholder power is used to influence corporate behaviour through direct corporate engagement, filing, co-filing shareholder proposals, and proxy voting in stocks or sectors: companies or a whole industry sector considered to be involved in unethical or immoral activities. Common examples include those involved in armaments, tobacco, alcohol, gambling and adult entertainment.

Social factors: The social issues considered by responsible investors when analysing investments. For example, a company may be assessed on its policies/ approach to human rights, modern slavery, child labour, working conditions and employee relations.

Socially responsible investment (SRI): Another term for responsible, sustainable or green investing, whereby ESG factors and values are integrated into the investment process.

Stewardship: 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. Typically, shareholder power is used to influence corporate behaviour through direct corporate engagement, filing or co-filing shareholder proposals, and proxy voting guided by comprehensive ESG guidelines.

Sustainability focus: Investment approaches that select and include investments on the basis of their fulfilling certain sustainability criteria and/or delivering on specific and measurable sustainability outcomes. Examples include sustainability-themed investing, best in class and positive tilt.

Sustainability-themed investing: A 'sustainability focus' approach where investments are selected on the basis of a sustainability theme(s) such as climate change mitigation, pollution prevention, sustainability solutions and approaches that relate to one or more of the UN Sustainable Development Goals (SDGs).

UN Social Development Goals (SDGs): 17 high-level goals forming the blueprint to achieve a better and more sustainable future for all. The aim is to achieve them all by 2030

Values-based investing: An investment approach that excludes investments on the basis of ethical, values based or religious criteria, for example, gambling, alcohol (also known as Ethical Investing)

10.2

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10.3

Industry links, bodies and organisations

Climate Action 100+

https://www.climateaction100.org/

Climate Action 100+ is an initiative taken by the investment industry to ensure the world's largest corporate greenhouse gas emitters take the necessary action on climate change. Signatories engage with companies to curb emissions, improve governance and strengthen climate-related financial disclosures.

International Financial Reporting Standards (IFRS) Foundation

https://www.ifrs.org/

A not-for-profit, public interest organisation established to develop a single set of high-quality, understandable, enforceable, and globally accepted accounting standards—IFRS Standards—and to promote and facilitate adoption of the standards.

UK Sustainable Investment & Finance Association

https://uksif.org/

UKSIF is the UK's membership network for sustainable and responsible financial services. UKSIF promotes responsible investment and other forms of finance that support sustainable economic development, enhance quality of life and safeguard the environment.

ESG and Ethical Fund Research

https://www.ethicalscreening.co.uk/

ESG, Responsible and Ethical funds online database. Free to access for advisers.

International Organization of Securities Commissions (IOSCO)

https://www.iosco.org/

The international body that brings together the world's securities regulators and recognized as the global standard setter for the securities sector. IOSCO develops, implements, and promotes adherence to internationally recognized standards for securities regulation.

The UK Stewardship Code

https://www.frc.org.uk/investors/uk-stewardship-code

The UK Stewardship Code, for which the Financial Reporting Council (FRC) is responsible, sets high expectations of those investing money on behalf of UK savers. It consists of 12 principles for asset managers and asset owners. It establishes a clear benchmark for stewardship as 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.

Task Force on Climate-related Financial Disclosures

fsb-tcfd.org

The Task Force on Climate-related Financial Disclosures (TCFD) develops voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers, and other stakeholders.

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How did you do?

Learning Objectives

Explain what ESG encompasses and how it specifically relates to tax-advantaged investements

- Covered in sections 1, What is ESG, 2, the Current context, 3, Performance, 4, Regulatory requirements, 5, Suitability, 6, Due diligence, 9, Case studies

Describe the main drivers for the development of ESG concerns in financial services

- Covered in section 2, the Current context and section 8, How intergenerational issues interact

Identify how current regulatory requirements apply in the tax-advantaged investments universe

- Covered in section 4, Regulatory requirements

Define how ESG and intergenerational issues intersect

- Covered in section 8

Determine the ESG investment strategies that match the clients' ESG objectives

- Covered in sections 1, What is ESG?, 3, Performance, 5, Suitability, 6, Due diligence, 9, Case studies

Steps After Reading

Claim your CPD

This guide is accredited for structured CPD by the PFS and CII and readers of the guide can claim one hour of CPD for each hour spent reading the guide (excluding breaks), up to a total of four hours. In order to claim structured CPD, readers will need to complete a short online test.

Go to *intelligent-partnership.com/cpd* for more details on claiming CPD.

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Intelligent Partnership actively welcomes feedback, thoughts and comments to help shape the development of this guide. This guide is produced on a regular basis.

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Participation and feedback are gratefully received

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Anyone who says the concepts of ESG do not affect them, or that they are not affected by them does not understand their wide-ranging importance. Aside from the climate change emergency, the massive shift to a collective social conscience cannot be ignored. Financial advisers failing to engage with this changing landscape not only miss the opportunity to drive positive global change, a chance to add enormous value to their advice and to reap the commercial benefits, but also risk regulatory censure and being recklessly out of step with the future.

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