A guide to sustainable investment

Fidelity INTERNATIONAL

Matching money to morals

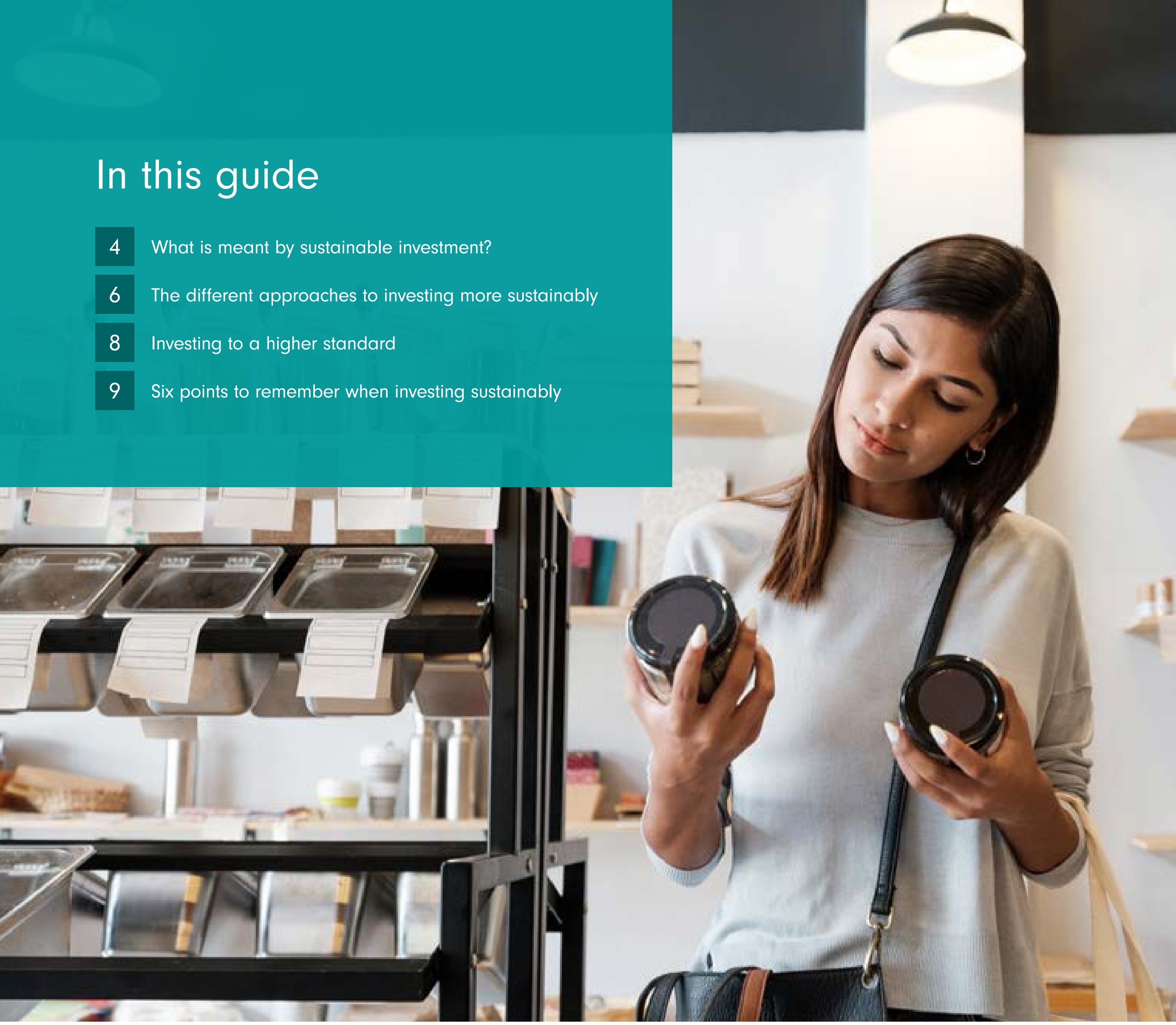
There have always been investors keen to match their money with their morals and sustainable (or responsible) investing has been around since the 1980s. Although sustainable investment remained a somewhat niche area for many years, this is now no longer the case.

As society becomes more conscious of environmental and social issues, such as climate change, human rights and diversity, we are now taking much more interest in how our money is invested. While generating good investment returns is still very important, today we're also increasingly focusing on how companies are generating those profits.

Important information

Please remember that past performance is not necessarily a guide to future performance, the performance of investments is not guaranteed, and the value of your investments can go down as well as up, so you may get back less than you invest. When investments have particular tax features, these will depend on your personal circumstances and tax rules may change in the future. This document does not contain any personal recommendations for a particular course of action, service or product. You should regularly review your investment objectives and choices and, if you are unsure whether an investment is suitable for you, you should contact your financial adviser. Before opening an account, please read 'Doing Business with Fidelity Adviser Solutions' and our Client Terms. Prior to investing into a fund, please read the relevant key information document which contains important information about the fund.

In this guide



More choice, less clarity

With a growing emphasis on sustainable returns, there has been a wave of interest in funds focused on sustainable investment. But wider choice potentially brings greater confusion – not just by investors but by fund managers as well. Should a stock involved in the oil industry, for example, be excluded from a fund even if it is making big strides to clean up its act?

In this guide, we aim to decode the concept of sustainable investment and look into why some investors regard certain companies as sustainable while others don't. We'll also highlight the different approaches taken by sustainably-managed funds. Your financial adviser can help you learn more about this area of investing. In particular, they can work with you to identify funds that are managed in ways that are consistent with your views, morals and long-term investment goals.

What does sustainable investment mean?

There are many terms used to describe sustainable investment, such as green, responsible, socially-responsible and impact investing. These are often used interchangeably even though they can signify differences in the way an investment is managed. Traditional ethical investing, for example, typically involves excluding companies from specific 'sin' sectors, such as those involved in the production and distribution of alcohol or tobacco. Impact investing, on the other hand, goes further and actively involves investing to make a positive social and environmental impact.

The Financial Conduct Authority (FCA), the UK financial services regulator, has recognised that investors need help identifying sustainable funds that may be appropriate for how they wish to invest. In November 2023, they announced the introduction of labels that fund providers can use, from 31 July 2024, if their funds meet the criteria. Your financial adviser can tell you more about these sustainable fund labels.

The E, S and G

Today, the common theme amongst responsible and sustainable investments is that they tend to focus to some degree on environmental and social standards as well as on how individual companies are managed (corporate governance). These areas are generally regarded as the three pillars of responsible investing. This has led to another term to describe this topic – ESG investing. The range of factors that fall under these three pillars are highlighted in the panel below.

Examples of the criteria fund managers commonly consider when investing sustainably

Environmental factors

How a company is addressing issues such as climate change, resource depletion, waste, pollution and deforestation

Social factors

A company's policies and record in relation to human rights, modern slavery, child labour, working conditions and employee relations

Governance factors

A company's record in relation to bribery and corruption, executive pay, board diversity and structure, political lobbying or donations and tax strategy.

When a fund manager meets with a company's board prior to making any investment, they may well quiz them on their ESG credentials. They'll be looking for signs that the firm is doing the right thing by their employees, the industry regulator, the environment and their surrounding communities. For instance, this could mean making sure staff are paid a good wage, there is a sensible approach to corporate risk management so any fines for bad practice are unlikely, and asking what the firm is doing to reduce pollution and support local initiatives.

Once a fund manager takes a stake in a business, they can drive positive change within that company. As a major shareholder, for example, they can encourage the company's management to become more sustainable or socially responsible. They can also use their considerable voting rights at shareholder meetings to either support or oppose plans put forward by the board. In this way, sustainably-managed funds can be a great option for today's conscious investor.

The different approaches to investing more sustainably

Sustainably-managed funds are not all managed in the same way, which is one reason the FCA has introduced sustainable fund labels. Some may specifically exclude stocks from certain industries, such as those involved in arms manufacturing or the extraction of fossil fuels. Conversely, another fund manager may invest in companies from these 'sin' sectors on the basis that their ESG credentials are moving in the right direction. In other words, the fund manager may support firms who are making a conscious effort to improve how they operate from a sustainable or responsible perspective.

It is therefore important to know how a sustainably-managed fund is run, particularly if you want to avoid certain stocks or industry sectors due to ethical, moral or religious considerations. We recommend that you talk to your financial adviser about any specific concerns you may have about how your money is invested. This will help them to identify the right fund(s) for you.

In order to make it easier to compare sustainably-managed funds, SRI Services, an independent and specialist business with over three decades of experience in sustainable investment, has classified every fund as one of seven 'SRI Styles'. These should not be confused with the sustainable investment labels introduced by the FCA. Definitions of these styles are shown below, although you should always check a fund's factsheet, prospectus and/or Key Investor Information Document for full details on its investment approach or policy.

1

Sustainability select*

These funds state they favour companies that offer products and services that encourage more sustainable lifestyles or show sustainability leadership. They also typically avoid sectors that don't help raise environmental and/or social sustainability standards, as well as arms and tobacco companies.

2

Environmentally focused*

These funds state they focus on environmental opportunities. Strategies vary. Funds may focus on a single issue like water, resource management or waste, to broader issues such as biodiversity and climate change.

3

Socially focused*

These funds state they focus on people issues – from employment and education, to diversity, equality and human rights. They typically invest in companies deemed to have positive social practices.

4

Ethically focused*

These funds state they focus on issues relating to personal values or opinions. Most avoid investment in companies that many regard as negative such as armaments, tobacco and gambling companies. They also typically invest in companies with higher environmental and social standards.

5

ESG (environmental, social and governance) weighted*

These funds state that they consider environmental, social and governance (ESG) or sustainability issues when making investment decisions, although how that information is applied varies. Funds in this group may favour companies with higher ESG or sustainability standards, but they don't necessarily exclude controversial companies as the manager may choose to try to encourage higher standards by engaging with company management.

6

Limited exclusions*

These funds typically only exclude a small number of companies. This may typically include some or all tobacco companies or companies that breach commonly-adopted environmental, social or governance (ESG) standards. They may aim to encourage companies to improve their standards.

7

Faith based*

These funds state they focus on faith-based issues. They tend to screen out companies that do not meet certain criteria to invest in assets that align with a recognised religion or faith. Other funds may also be suitable for investors of faith, although their core focus is not religious beliefs.

*An SRI Style based on the SRI Services fund categorisation system.

Sustainable investing standards

Several principles and ideals act as a common reference point for fund managers who invest sustainably. Examples of some high-profile and important industry standards are highlighted below. Ensuring that the manager of a fund has signed up to these codes or principles may be an important factor when choosing a fund for your portfolio. Your adviser will be able to help establish whether or not a fund manager meets these standards.

- From 31 July 2024, fund providers can choose to use an **FCA sustainable investment label** if their fund meets the criteria. Funds that have labels need to give investors clear and simple information, including what the sustainability goal is, the approach to achieving it, and annual updates on progress towards the goal.
- The UN-supported **Principles for Responsible Investment (PRI)** is regarded as the world's leading proponent of responsible investment. It has issued a set of voluntary and aspirational investment principles that all signatories must commit to. Signatories are regularly assessed on their progress against targets and peers.
- **The UK Stewardship Code** sets high expectations of those investing money on behalf of UK savers. It consists of 12 principles which encourage the responsible allocation and management of capital.
- **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.
- **Net-Zero Asset Manager Initiative** is a group of international asset managers committed to supporting the goal of net zero greenhouse gas emissions by 2050 or sooner, in line with global efforts to limit warming to 1.5 degrees Celsius; and to supporting investing aligned with net zero emissions by 2050 or sooner.

The UN's Sustainable Development Goals (SDGs)

Launched in September 2015, these 17 high-level goals form a blueprint to achieve a better and more sustainable future for all. The aim is to achieve them all by 2030.

These goals are influencing fund managers in many ways. Firms may take these into account when choosing which businesses to invest in, for instance, and when engaging with the companies as shareholders.

Six points to remember when investing sustainably

1. **Very few sustainable investing issues are straightforward.** There are almost always ambiguous areas to explore and decipher.

2. **There is no ideal size of company.** Smaller businesses often lead change but, for our lifestyles to become more sustainable, bigger companies need to be encouraged to change too (and many of them are already doing so).

3. **Larger companies tend to be more diverse than smaller ones.** They are more likely to do things that you may not necessarily agree with. Try to bear this in mind.

4. **No one's perfect.** Most companies have positive and negative attributes – no business is entirely ethical or unethical. Companies will probably make mistakes from time to time.

5. **Sustainable funds are not all the same.** Different fund managers have different policies and may – or may not – exclude companies involved in specific activities.

6. **Always speak to your financial adviser before making any investment decisions.** Tell them about any ethical, moral or religious factors that are important to you that should be taken into account when investing your money.

Want to know more about investing sustainably?

If you have any questions or simply want more information about sustainable investment, speak to your financial adviser. They will be able to discuss the different approaches with you and, if appropriate, recommend funds and other investments that are managed in a way that are consistent with your views and investment objectives.

If you have any questions about the investments or services we provide, please speak to your adviser in the first instance.

Alternatively, call us on **0800 358 4060** or visit **fidelity.co.uk/clients**