STANDARDS BOARD FOR ALTERNATIVE INVESTMENTS

Responsible Investment Policy Framework

SBai Toolbox

1. Introduction

Responsible Investment ("RI")[1] is a growing area of interest for asset managers, investors and increasingly regulators. While many RI-related factors have long been present in fundamental analysis, without being explicitly named so, there is now a growing expectation amongst institutional investors, that asset managers develop an RI Approach and disclose this approach via an RI Policy. Historically RI was associated with value or norms-based security exclusions, but as awareness around RI issues grows globally, investors now have different motives for considering RI in the investment process, including the financial materiality of RI-related risks. This has led to spectrum of approaches to RI.

This SBAI Toolbox memo is intended to be a non-prescriptive framework for alternative investment managers to develop an approach to RI and to document this approach in an RI Policy. This framework is designed to be used in conjunction with supplemental strategy memos that will be published by the SBAI in the coming months. These supplementary memos will take a deeper dive into the practical implementation of an RI Approach within different alternative strategies[2].

This memo contains discussion on the following areas of building and documenting an RI Approach:

- **Foundations of an RI Approach**: Key considerations including the key drivers, the spectrum of approaches, resource requirements, data, and the impact of RI on products.
- **Building Blocks of an RI Approach**, including:
  - *Responsible Integration*
  - *Responsible Asset Selection*: Exclusions, Inclusions, and Impact
  - *Responsible Ownership*: Voting, Engagement, and Activism
  - *Responsible Corporate and Market Citizenship*: Organisational Initiatives, Good Market Citizenship, and Carbon Offset and Hedging

Section 5 consolidates this into a framework for disclosures within an RI Policy.

The Appendices to this memo contain more detailed discussions on the individual topics raised as well as a resource guide for RI-related material that asset managers and investors can use to enhance their understanding of the topic.

[1] Responsible Investing is also known as ESG Investing, Sustainable Investing
[2] Long/Short Equity, Credit, Macro Income, Insurance Linked and Systematic.

2. Foundations of an RI Approach – Key Considerations

When developing an RI Approach there are several considerations that must be assessed. These include the spectrum of approaches to RI, resourcing, data, and any financial impact on products.

2.1 Spectrum of Approaches to RI

An asset manager's approach to RI will sit on a spectrum depending on the level of integration.

Spectrum of Responsible Investment Frameworks

No consideration	Client requests only	Firmwide baseline	RI integrated	RI focused
Responsible Investment is not specifically considered in any investment decisions for any mandates. Note that some elements (particularly "E" and "G") are likely indirectly considered through standard risk analysis.	Exclusion lists provided by clients are applied as investment restrictions to Separately Managed Accounts (SMAs) or Funds of One. No exclusions are applied to commingled or pooled funds.	Firms may choose to apply baseline exclusions (e.g., controversial weapons or tobacco) to all investment mandates within the firm. This may also include elements of stewardship (G) and proxy voting. Firms may support climate (E) and diversity (S) measures in votes.	RI specific data is included in the analysis for all investment decisions. This may be third-party RI metrics, internal or external ratings or other RI data. This data is one of many data sets and has no priority over other risk or reward factors.	Products that have a specific mandate to invest responsibly. This could include exclusions of issuers with low ESG ratings, investment in specific sectors such as renewable energy or driving change through investment or lending amongst other examples.

A firm may offer different products that sit within different parts of this spectrum, for example, a baseline approach the entire firm follows, but different levels of integration within different products. To determine a firm's approach there are several key assessments to make:

Consideration	Key Assessment
Investor Requests	• Understand investor expectations and philosophies. • Assess specific requirements for the investment strategy.
Firm Philosophy	Explore the personal philosophies of the founders, the investment team, and other staff in the organisation.
Regulatory Requirements*	• Monitor regulatory developments for asset managers. • Understand any investor regulatory requirements that may influence allocation decisions.
Strategy Considerations**	Assess the materiality of RI factors as a function of: • Investment strategy, • Investment style, • Asset classes in the portfolio, • Holding periods, and • Position sizing and concentration.
Competitive Landscape	• Understand RI products that have been implemented by peers. • Assess how their RI Approaches are articulated.

*See the SBAI Toolbox Memo – Review of Regulatory Expectations for RI

**Subsequent SBAI Memos on strategy specific considerations will expand on this in more detail.

2.2 Resources

The specific RI Approach will give rise to certain resource requirements. This may include the need to hire additional staff or train existing staff. This will be a focal point in investor due diligence and having the right level of resources for the stated objective will mitigate "greenwashing" [3] concerns.

2.3 Data

Data is an essential component for an RI Approach and its role is often underestimated in the development phase of an RI Approach. Key considerations include:

- **Data Availability:** data is not freely available in all jurisdictions and as a result the use vendors or the sourcing data independently may need to be considered.
- **Data Vendors:** an understanding of the different methodologies and assumptions used by each provider will be required.
- **Resources:** collecting, analysing, and processing data can be resource intensive.

Appendix A provides a detailed overview of the key considerations for RI data.

2.4 Impact on Alpha

Asset managers have a fiduciary duty and as such should assess the potential impact the RI Approach may have on performance. Investors may make conscious choices to forego some sources of alpha; however, asset managers need to understand any potential alpha impacts from decisions to introduce RI into existing products.

Potential Inclusions for an RI Policy:

- What is the manager's high level RI objective – is RI treated as source of alpha, a risk management tool, or the primary goal of the portfolio?
- Where does the firm sit on the spectrum of RI Approaches?
- Does the manager intend to run any dedicated RI products?
- Is the manager a signatory to any third-party responsible investing organizations (including the SBAI)?
- What resources will be dedicated to the RI Approach?
- Are there any sources of alpha that are excluded from the product and what is the rationale for doing so?

3. Building Blocks of an RI Approach

This section provides a framework to use for designing an RI Approach. The outcome of this framework will result in the most detailed disclosures in the RI Policy.

There are a variety of approaches to RI and an asset manager will need to determine which are both appropriate, and practical, for the firm's products and stated RI objectives. The approaches are not mutually exclusive, products may contain all, some, or none of these features:

[3] Greenwashing is the process of conveying a false impression or providing misleading information about the environmental soundness of a company's products. Greenwashing is considered an unsubstantiated claim to deceive consumers into believing that a company's products are environmentally friendly.

Different Approaches to Responsible Investment

Responsible Integration		The Inclusion of RI-related factors into investment and risk management processes, where they have financial materiality. This involves the use of all relevant financial and non-financial information to aid asset valuation and risk assessment, but RI factors are not used to pre-define an asset universe.
Responsible Asset Selection	Exclusions	An “Exclusion List” or “Negative Screening” is used to pre-define an investment universe. Exclusions may be based on “damaging industries” such as gambling, fossil fuels, or tobacco, relatively low ESG ratings or other considerations such as faith-based investing.
	Inclusions	“Positive Screening” is used to pre-define an investment universe. Inclusions may be on a “best in class” basis, i.e., those with relatively high ESG ratings or on a “thematic” basis with investments in particular sectors or industries targeted.
	Impact	Investing with the specific goal of delivering meaningful societal and environmental outcomes, for example, reduction of carbon emissions, or more generally contributing to societal goals such as the UN’s Social Development Goals (SDGs).
Responsible Ownership	Voting	A form of engagement based on participating in Annual Company Meetings and using voting rights to support RI-related initiatives or express a negative view on current practices.
	Engagement	Having a dialogue with underlying issuers or companies with a view to achieving improvements on RI-related practices. This can also be used for improvements in wider industries through collective engagement for example with regulators or investor groups.
	Activism	A more involved form of engagement where investors look to promote change through building up a significant holding within a company and potentially gaining a seat on the board. This may also be a more public form of engagement.
Responsible Corporate & Market Citizenship	Organisational Initiatives	Initiatives and policies put in within the Investment Manager’s own firm to address environmental, social and governance issues for example, energy efficiency, diversity, and employee wellbeing.
	Good Market Citizen	Being a responsible market citizen by governing the firm’s behaviour in the market and ensuring the maintenance of free and effective markets, for example, by having strong controls in place to prevent market abuse.
	Carbon Hedging	Offsetting carbon emissions either directly produced by the firm (for example via travel) or funded within the portfolio (for example by investing in high carbon emitters) using carbon credits or other forms of carbon hedging.

The following sections discuss each of these areas at a high level and <u>Appendices B to H</u> contain a more detailed assessment of each topic.

3.1 Responsible Integration

> The Inclusion of RI-related factors into investment and risk management processes, where they have financial materiality. This involves the use of all relevant financial and non-financial information to aid asset valuation and risk assessment, but RI factors are not used to pre-define an asset universe.

Elements of RI Integration have historically been present in traditional research processes particularly where these factors have a financially material impact. Approaches to RI Integration can be qualitative or quantitative and the materiality of E, S and G factors will vary for different asset classes and strategies. Investment, research, and risk resources should be focused on the RI-related risks that are most financially material to the strategy.

RI Integration is distinct from “ethical” or “socially responsible” investing which would typically pre-screen the investment universe in advance of selecting assets.

For a more detailed discussion on RI Integration please see Appendix B.

Potential Inclusions for an RI Policy:

- Details of how RI-related factors are integrated into the investment decision-making process (including asset allocation, security selection, portfolio construction and risk management).
- An explanation of what factors or thresholds will determine if an RI-related factor is considered material or non-material.
- Details of any quantitative (or qualitative) analysis that is used to determine the risk/reward attribution of a specific RI-related factor and how will this be evaluated.
- Details on any sources of data, and any estimates or assumptions that will be used in the decision-making process.

3.2 Responsible Asset Selection

This section discusses three types of Responsible Asset Selection:

Exclusions	Inclusions	Impact Investing

3.2.1 Exclusions

An “Exclusion List” or “Negative Screening” is used to pre-define an investment universe. Exclusions may be based on “damaging industries” such as gambling, fossil fuels, or tobacco, relatively low ESG ratings or other considerations such as faith-based investing.

RI-related exclusions aim to align investments with the investor’s or firm’s ethical values, religious beliefs, societal norms and/or principles. Exclusions can be product-based using simple screening to exclude securities in “damaging industries” such as alcohol, tobacco, gambling, or fossil fuels. Alternatively, exclusions may be more dynamic, based on either externally sourced or proprietary ESG Ratings.

Key Considerations for an Exclusion Approach include:

- **Strategy Considerations:** Factors such as asset class, investment time horizons and the direction of trading (long vs short) will all have effectiveness implications.
- **Fiduciary Duty:** Securities such as tobacco, gambling or fossil fuels may be “cheap” due to the movement of capital away from these industries. This may mean they can provide higher returns than more “virtuous” industries.
- **Binary Nature of the Decision:** An exclusion list is binary; a security is either excluded or it is not. There may be limited scope to appreciate nuances that could have a financially material impact.
- **When “E” becomes “S”:** Mass divestment of industries such as fossil fuels, where there is no effective replacement, may have unintended social consequences. These could include job losses and potentially depriving emerging markets of access to industries required for basic infrastructure.
- **Divestment vs Engagement:** Divestment can result in increased cost of capital for a company and act as an incentive for improvement, but there is also an argument that engagement can achieve the same results. Exclusions could be used as a last resort following engagement.

For a more detailed discussion on RI Exclusions please see Appendix C.

Potential Inclusions for an RI Policy:

- Will the manager consider exclusion lists provided by investors?
  - If yes, what are the criteria for this i.e., requires an SMA of a certain size or must not restrict the current investment universe if applied to a commingled fund.
- Detailed descriptions of the criteria for exclusion of securities from the portfolio.
- Can these criteria be changed and if so, what is the process for doing this?
- How is the investment universe determined both before and after the exclusions?
- What are the governance processes for ensuring the correct exclusions have been applied?
- What sources of data, estimates or assumptions will be used in the decision-making process?

3.2.2 Inclusions

"Positive Screening" is used to pre-define an investment universe. Inclusions may be on a "best in class" basis, i.e., those with relatively high ESG ratings or on a "thematic" basis with investments in particular sectors or industries targeted.

There are two main approaches to inclusions[4]:

- **"Best in Class":** Using selection criteria to invest in, or overweight exposure to, companies, issuers or countries that perform relatively better on relevant RI-related metrics such as external ESG ratings, greenhouse gas emissions, gender diversity, human rights records, and others.
- **"Thematic":** Defines the investment universe by focusing on sectors or industries that the asset manager believes will provide returns, whilst also contributing to RI-related goals. For example, funds may focus on renewable energy providers or carbon reduction products.

Key Considerations for an Inclusion Approach include:

- **Crowding:** There are concerns that crowding[5] may result from investing based solely on third party ESG ratings or other similar criteria (particularly with scale of passive money entering this space). This could result in investing in overvalued assets and potentially reduce expected future returns. This will be particularly important when trading single name assets that have high ESG scores across multiple vendors.
- **Alignment of Data with Objectives:** Where inclusions are defined using external data there is a risk that the methodology of the vendor may not align with the investment mandate. Due diligence of the methodologies of vendors is therefore critical.
- **Resourcing:** Thematic inclusions may be more resource intensive than relatively more simple inclusion or exclusion strategies.
- **Effectiveness Challenges:** There will be many of the same effectiveness challenges as exclusions; however, inclusions do provide more opportunities for engagement to generate further value from improvements than exclusions.

[4] Inclusions differ from RI Integration as RI-related metrics are specifically used to determine an investment universe prior to asset selection. It is also likely these portfolios will have one or more RI specific goals in their investment mandates.
[5] The convergence of investors on the same or similar stocks due to a tendency to focus on a similar set of factors.

For a more detailed discussion on Best-in-Class Inclusions please see Appendix D and for Thematic Inclusions Appendix E.

Potential Inclusions for an RI Policy

- What are the criteria that will be used to determine the investment universe?
- How will these metrics and other information be sourced or calculated?
- How and when will these metrics be used within the investment decision-making process?
- If over-weighting assets on an inclusion list, how will the relative weightings be calculated?
- How will the portfolio be monitored against these metrics on an ongoing basis and how often will any rebalancing of the portfolio take place?
- How will the risk of crowded trades be monitored as part of investment and risk management processes?
- How are investment choices contributing to the stated RI objective of the investment mandate?

3.2.3 Impact

Investing with the specific goal of delivering meaningful societal and environmental outcomes, for example, reduction of carbon emissions, or more generally contributing to societal goals such as the UN's Social Development Goals (SDGs).

Impact investing has similarities to thematic inclusion approaches, but there are some differences. Impact investing will have a specific goal of delivering meaningful societal and environmental outcomes. This may involve investment in smaller or start-up companies and is likely to include higher levels of engagement.

Key Considerations for an Impact Approach include:

- **Setting Impact Goals:** Examples could include a contribution to the UN's Sustainable Development Goals (SDGs)[6], improvements in areas such as carbon emissions or a more general goal of investing in low ESG scoring companies to improve them through engagement.
- **Measurement:** The key challenge with this approach is to show investors the "impact" of the investments. Tracking this during initial research and ongoing monitoring of the investments will be crucial and is discussed further in Section 4.1.1.

For a more detailed discussion on Impact Investing please see Appendix F.

Potential Inclusions for an RI Policy

- What are the Impact Goals of the portfolio?
- What are the impact metrics and targets that will provide investment decision information?
- What are the exit criteria for an investment that is no longer contributing towards the impact goals?
- How will the portfolio be reviewed and measured against the impact goals and how will this assessment be reported to investors?

[6] https://sdgs.un.org/goals

- What are the non-impact related factors that may cause an investment to be exited, for example a stop loss on the investment?

3.3 Responsible Ownership

This section discusses three areas of Responsible Ownership:

Voting	Engagement	Activism

For a more detailed discussion on these areas please see Appendix G.

3.3.1 Voting

A form of engagement based on participating in Annual Company Meetings and using voting rights to support RI-related initiatives or express a negative view on current practices.

Voting rights are typically only granted to holders of direct equity and some debt positions. These rights allow voting on company resolutions, some of which may be related to RI factors. Asset managers typically approach voting in one of three ways:

- Abstaining from voting
- Voting directly on each resolution, or
- Outsourcing to third party proxy voting companies

Key Considerations for Voting include:

- **Proxy Voting Policies:** These can be enhanced for RI factors such as voting for environmental measures or against executive compensation or board reappointments where RI-related targets are not met[7].
- **Outsourced Voting:** This will likely be less nuanced and may focus on environmental measures only. Asset managers should understand any third-party's view on RI factors.

3.3.2 Engagement

Having a dialogue with underlying issuers or companies with a view to achieving improvements on RI-related practices. This can also be used for improvements in wider industries through collective engagement for example with regulators or investor groups.

There are two forms of engagement that can be used by an asset manager:

- **Direct Engagement:** Engaging directly with issuers including on RI-related factors.
- **Collective Engagement:** Engagement via collaborative groups such as investor collectives, industry associations, exchanges, or regulators.

Key Considerations for Engagement include:

[7] The SBAI Alternative Investment Standards Section 25 covers governance of Proxy voting - https://www.sbai.org/standards/

- **Strategy Limitations:** Direct engagement will be most effective for concentrated equity (or direct debt) portfolios that rely on fundamental analysis. Other alternative strategies will be limited in their ability to do this.

3.3.3 Activism

A more involved form of engagement where investors look to promote change through building up a significant holding within a company and potentially gaining a seat on the board. This may also be a more public form of engagement.

Activism is a more involved or extreme form of engagement that is only available to relatively large equity holders with the resources and experience in this type of strategy. This strategy could be used to target a company with inferior RI credentials with the view to making improvements via replacing management or putting (sometimes public) pressure on management to improve these practices.

Potential Inclusions for an RI Policy

- What is the proxy voting policy and is this achieved through direct voting or outsourced voting?
- Will the manager's proxy voting records be made available to investors and if so, how regularly?
- How is engagement on RI-related issues factored into the investment process and at what point?
- Where engagement is completed to improve RI-related factors as a matter of policy, what are the criteria and metrics for how this will be assessed?

3.4 Responsible Corporate and Market Citizenship

This section covers three areas that sit outside of the investment approach:

Organisational Initiatives	Good Market Citizenship	Carbon Offset or Hedging

For more detailed examples of these types of initiatives please see Appendix H.

3.4.1 Organisational Initiatives

RI Policies can also detail steps taken by the firm to be mindful of E, S and G considerations. Investors will likely ask about the firm's efforts outside of its investment process as part of their due diligence on RI frameworks.

Examples of Organisational Initiatives Include:

- **Environmental Measures:** Reducing the environmental footprint of technology, sustainable travel and meeting practices, responsible waste and recycling processes, and energy efficiency.
- **Social Measures:** Treatment of employees, diversity initiatives, charitable contributions, community initiatives, supply chain management, and health and wellbeing benefits.
- **Governance Measures:** Alignment with the SBAI Alternative Investment Standards, transparency, code of ethics and strong policies and governance procedures.

Potential Inclusions for an RI Policy

- What is the asset manager doing at a firm level?
- What environmental policies has the firm put in place?
- What social policies has the firm put in place?
- What governance processes has the firm put in place? (this section can refer to other procedure documents or policies and does not need to replicate all governance controls).
- Who oversees the organisational policies?

3.4.2 Good Market Citizenship

Being a responsible investor is wider than asset selection and ownership. It applies to investor's actions in the market regardless of asset class or investment style.

Examples of Good Market Behaviour Include:

- **Market Policies:** Strong policies and controls in place on areas such as MNPI[8], Market Abuse and Personal Trading.
- **Awareness:** Be aware of your role in the market and the impact trade execution can have on market functioning.

3.4.3 Carbon Offset and Hedging

This is the process of calculating the extent that a portfolio (or firm) is funding emissions and then purchasing offsets for the same amount, for example by purchasing carbon credits.

Key Considerations for Carbon Hedging:

- **Measurement:** This can be challenging and requires data on Scope 1 and Scope 2 emissions at a minimum (a lot of current metrics do not account for Scope 3 emissions)[9].
- **Pricing:** Valuation of carbon is relatively unstable and inconsistent, although this is likely to improve over time.
- **Shorting:** A methodology to account for short positions would need to be defined.
- **Effectiveness:** Is this really changing behaviour or just allowing firms to "absolve" themselves of emissions? It does have the effect of pricing carbon which may lead to a decrease in funding of emissions.

Potential Inclusions for an RI Policy

- Does the manager offset carbon?
- If yes, how is it measured and accounted for?
- What instruments are used to offset the carbon emissions?

3.5 Governance and Disclosure

RI Policies, like all effective policies, need to be governed and where possible measured. The level of oversight will be dependent on the RI Approach and whether any products are marketed as RI Products.

[8] Material Non-Public Information
[9] Scope 1 is All Direct Emissions, Scope 2 is Indirect Emissions from electricity and Scope 3 is all other Indirect Emissions (e.g., business travel, procurement, waste, water etc.)

3.6 Defining Measurable Goals for RI Products

Creating measurable goals for any dedicated RI products is a way to alleviate concerns of "greenwashing". The RI Policy should clearly define a mandate for these products. As part of the governance of this policy, measurable goals for the product need to be set against this mandate. Asset managers will need to define what metrics they are able to measure before determining measurable goals.

Depending on the scope or focus of the RI product, goals could take many forms, including:

- Benchmarking of the portfolio against a relevant index,
- Measuring of the achievements within an impact portfolio (see below),
- Tracking of ESG ratings over time,
- Measuring the carbon footprint of a portfolio,
- Measuring contribution to the UN SDGs, or
- Measuring the overall ESG rating of a portfolio.

Measuring Impact Investments

There are different ways that impact investments can be measured, such as alignment with the UN SDGs or making use of measurement frameworks available from organisations such as the Impact Management Project[10] and the Sustainable Accounting Standards Board (SASB)[11]. measurement processes may be backward looking, require manual mapping, or require dedicated research to proactively identify suitable investments. All measurement processes are likely to be subjective. Having an impact investment committee or forum may help to make the process more robust.

Key considerations for measuring impact include:

- **Causality:** Can you prove the investment made a difference?
- **Beneficiary:** Detail should be provided on who is the intended beneficiary of the impact.

Potential Inclusions for an RI Policy

- What are the measurable goals of the investment mandate?
- At what frequency are these goals monitored?

3.7 Documentation

Once an asset manager has determined its RI Approach, it should also determine how this will be documented. The RI Policy should contain details of how the process is formalised in a repeatable way, for example as part of research documentation, investment rationales, or compliance reviews.

4.2.1 Disclosure requirements

When determining which elements of RI will be included within an asset manager's strategy, consideration should also be given to how this can be communicated effectively to investors. Investors should be able to view the RI Policy of the firm and will likely expect more detailed reporting for RI Products.

[10] https://impactmanagementproject.com/
[11] https://www.sasb.org/

3.8 Oversight

Depending on the structure (and size) of the organisation and the specific type of RI Approach, there are several ways to approach oversight:

- **RI Committee:** For larger organisations this can bring together overlapping functions in a forum for oversight and decision-making.
- **Dedicated RI Team:** Some firms will create a dedicated RI team that will be responsible for the process. Ideally this team should have close interactions with the Investment Team to ensure any RI philosophy is consistent across the investment process.
- **Investment Team:** This may be achieved by having dedicated research analysts focusing on specific RI areas sitting within the Investment Team and contributing to investment analysis.
- **Compliance Team:** Compliance teams may oversee the process to ensure compliance with any stated aims and measure goals on RI Products. Ideally this responsibility should be shared with the Investment Team to demonstrate full integration across the investment process.

Key Considerations for Oversight of the RI Approach include:

- **Seniority:** There should be a dedicated senior individual or team that is responsible for the governance of the policy. For an RI dedicated product, the individual or team should be responsible for ensuring investments are in line with the mandate in a measurable way.
- **Resources and Training:** Any resources with RI responsibilities should be provided with the appropriate amount of training for their role.

For more detailed discussion on RI Oversight please see Appendix I.

Potential Inclusions for an RI Policy:

- Which individuals or teams are responsible for the governance of the policy?
- What oversight is completed?
- For RI Products, what are the measurable goals of the investment mandate?
- What reporting can investors expect to receive, and on what frequency?

4. Framework to Build a Responsible Investment Policy

Working through this framework to design an RI Approach will help an asset manager to determine what needs to be disclosed within an RI Policy. This will also assist in providing detailed responses required in RI DDQs such as the UN PRI's Hedge Fund DDQ[12].

The below framework summarises the potential disclosures in an RI Policy.

[12] https://www.unpri.org/hedge-funds/responsible-investment-ddq-for-hedge-funds/125.article

Area	Observations
Overview	• What is the manager's high level RI objective – is RI treated as source of alpha, a risk management tool, or the primary goal of the portfolio? • Where does the firm sit on the spectrum of RI Approaches? • Does the manager intend to run any dedicated RI products? • Is the manager a signatory to any third-party responsible investing organizations (including the SBAI)? • What resources will be dedicated to the RI Approach? • Are there any sources of alpha that are excluded from the product and what is the rationale for doing so?
Responsibility	• Which individuals or teams are responsible for the governance of the policy?
Monitoring, Governance	• What oversight is completed? • For RI Products, what are the measurable goals of the investment mandate? • What reporting can investors expect to receive, and on what frequency?
Organisational Initiatives	• What is the asset manager doing at a firm level? • What environmental policies has the firm put in place? • What social policies has the firm put in place? • What governance processes has the firm put in place? (this section can refer to other procedure documents or policies and does not need to replicate all governance controls). • Who oversees the organisational policies?
Carbon Hedging	• Does the manager offset carbon? • If yes, how is it measured and accounted for? • What instruments are used to offset the carbon emissions?
RI Integration	• Details of how RI-related factors are integrated into the investment decision-making process (including asset allocation, security selection, portfolio construction and risk management). • An explanation of what factors or thresholds will determine if an RI-related factor is considered material or non-material. • Details of any quantitative (or qualitative) analysis that is used to determine the risk/reward attribution of a specific RI-related factor and how will this be evaluated. • Details on any sources of data, and any estimates or assumptions that will be used in the decision-making process.
Exclusions	• Will the manager consider exclusion lists provided by investors? – If yes, what are the criteria for this i.e., requires an SMA of a certain size or must not restrict the current investment universe if applied to a commingled fund. • Detailed descriptions of the criteria for exclusion of securities from the portfolio. • Can these criteria be changed and if so, what is the process for doing this? • How is the investment universe determined both before and after the exclusions? • What are the governance processes for ensuring the correct exclusions have been applied? • What sources of data, estimates or assumptions will be used in the decision-making process?

Inclusions	• What are the criteria that will be used to determine the investment universe? • How will these metrics and other information be sourced or calculated? • How and when will these metrics be used within the investment decision-making process? • If over-weighting assets on an inclusion list, how will the relative weightings be calculated? • How will the portfolio be monitored against these metrics on an ongoing basis and how often will any rebalancing of the portfolio take place? • How will the risk of crowded trades be monitored as part of investment and risk management processes? • How are investment choices contributing to the stated RI objective of the investment mandate?
Impact	• What are the Impact Goals of the portfolio? • What are the impact metrics and targets that will provide investment decision information? • What are the exit criteria for an investment that is no longer contributing towards the impact goals? • How will the portfolio be reviewed and measured against the impact goals and how will this assessment be reported to investors? • What are the non-impact related factors that may cause an investment to be exited, for example a stop loss on the investment?
Voting, Engagement & Activism	• What is the proxy voting policy and is this achieved through direct voting or outsourced voting? • Will the manager's proxy voting records be made available to investors and if so, how regularly? • How is engagement on RI-related issues factored into the investment process and at what point? • Where engagement is completed to improve RI-related factors as a matter of policy, what are the criteria and metrics for how this will be assessed?
Data	• What is the source of the data for the selected vendor(s)? • Does the data cover enough of the investment universe to be effective in the investment process or for investor reporting? • Where the data is sourced from public information, how reliable is the data in the geography of the investment universe? • How much weight is given to "E", "S" or "G" factors and is appropriate for the stated RI objectives? • For more subjective social factors, is large scale vendor data appropriate or would a more focused data provider be required? • Have multiple vendors been reviewed and tested and why were specific vendors chosen? • What is the methodology behind any scoring from vendors and what assumptions are used? • If choosing to source the data independently, ensure the firm has sufficient resources both in terms of bandwidth and local knowledge of the relevant jurisdiction.

Appendices

The appendices to these memos contain further detailed discussion of the topics referenced in Sections 2 to 4 and a resource guide for further information:

Appendix A
Responsible Investment Data and Frameworks

For any of the RI Approaches described in this memo, asset managers will need to source data on RI-related risks and potentially other metrics. Data may be sourced directly or via a third-party vendor and can be used to generate proprietary scores or opinions or, to pre-define an investment universe.

There are many vendors of RI data and the space continues to grow. The key to quality data is consistency and comparability across assets in the investment universe. There are challenges associated with this which are described later in this section.

There are multiple types of data available from different vendors as detailed below:

Fundamental Data	Comprehensive Data	Specialist Data
Providers collect publicly available data. These providers will typically not provide ESG "Scores" or "Ratings"	Providers will obtain a combination of both objective and subjective data. Providers will use large numbers of metrics across E, S and G elements to determine an ESG "Score" or "Rating"	Providers will specialise in a specific area such as Environmental or Carbon Scores, Corporate Governance, Human Rights or Gender Diversity
Examples: Refinitiv, Bloomberg	**Examples:** MSCI, Sustainalytics, Vigeo Eiris, ISS, TruValue Labs, RepRisk	**Examples:** TruCost (now owned by S&P Global), Carbon Disclosure Project, Equileap

A1 Data Challenges

Across all asset classes, data is often cited as one of the most challenging aspects of developing an RI Approach. Common complaints include inconsistency of ratings across vendors and aggregation into a single ESG score, as opposed to individual scores for E, S and G components. Given the subjective nature of RI this may also be viewed positively by some asset managers as a potential source of alpha or a chance to select a vendor more in line with the objectives of the strategy.

A1.1 Source of Data

There are vendors that specialise in sourcing data related to specific RI-related factors, but most ESG ratings will be reliant on disclosures from companies, countries, or issuers. This can cause inconsistency as not all jurisdictions (or issuers within the same jurisdiction) will have the resources to provide consistent metrics that can be used to make direct comparisons.

Data is generally biased towards European large cap companies due to mandatory disclosures in that jurisdiction. There are also many large cap US companies that produce this data due to investor demand. Sourcing data from Asia is more challenging as there is little standardisation and this can be seen through language, culture, and knowledge variations.

A1.2 Aggregated Scores

RI-related ratings are typically a simplification of complex analysis and the weightings for third party aggregated scores may differ. Some may be more heavily weighted towards "E", "S" or "G" factors, making comparisons challenging. Ratings will also vary due to the unique methodologies used by vendors to assign company-specific ratings. This source of inconsistency can be described as a challenge or as an opportunity to select the vendors most aligned with the asset manager's RI objectives.

This inconsistency highlights the subjective nature of the assumptions used within different methodologies and the importance of each manager conducting due diligence to ensure vendor methodologies are in line with their objectives. This is also true where "E", "S" and "G" factors are reported separately.

A1.3 Internal Data

Asset managers may choose to source their data via fundamental analysis or engagement with companies. This will be difficult for managers that hold many positions or have a high portfolio turnover and is more suited to relatively concentrated, buy and hold strategies. It will require appropriate resourcing and training for the individuals involved including local knowledge of the investment universe. Financially material factors will vary regionally and by industry, for example the same expectations on carbon emissions may not be appropriate for developed markets versus for emerging markets.

A1.4 "S" Metrics

Data to produce social metrics is limited and often incomplete. Companies can hide behind public declarations of support for social causes. The Covid-19 pandemic starting in 2020 offered investors the first real chance to measure or observe in practice some of these public declarations. Employee welfare has come under increased scrutiny and moved investor pressure to sectors such as services, financials, and healthcare as well as the more traditional areas of fossil fuels, mining, and utilities.

A1.5: Risk of Greenwashing by "Cherry Picking"

The use of quantitative scoring via third-party vendor ratings can be open to greenwashing via cherry picking data that shows the portfolio in a more positive light. Asset managers should ensure to document the data vendor selection process, including methodologies used by the vendors and why the chosen vendor is appropriate for the product or strategy. Vendors typically offer free trials of data which can be used to complete a full analysis.

A2 Frameworks

In addition to ESG data and ratings there are many frameworks available, for example SASB, which can provide industry specific aspects that can be factored into internal analysis and documentation. These frameworks provide standards for reporting and some provide materiality maps to help assess financial materiality in different industries and sectors.

Considerations for Asset Managers

- What is the source of the data for the selected vendor(s)?
- Does the data cover enough of the investment universe to be effective in the investment process or for investor reporting?
- Where the data is sourced from public information, how reliable is the data in the geography of the investment universe?
- How much weight is given to "E", "S" or "G" factors and is appropriate for the stated RI objectives?
- For more subjective social factors, is large scale vendor data appropriate or would a more focused data provider be required?
- Have multiple vendors been reviewed and tested and why were specific vendors chosen?
- What is the methodology behind any scoring from vendors and what assumptions are used?
- If choosing to source the data independently, ensure the firm has sufficient resources both in terms of bandwidth and local knowledge of the relevant jurisdiction.

Appendix B
RI Integration

RI Integration is often viewed as a baseline approach as asset managers should take all material risks into account in their investment process.

B1 Observations and Characteristics

- **Acknowledgement of Financial Materiality:** RI integration acknowledges that elements of RI (for example environmental risks) may have a financially material impact on the investment.
- **No Pre-definition of Investment Universe:** RI Integration does not pre-define the investment universe using exclusions or inclusions based solely on RI-related metrics.
- **Variety of Approaches:** These can be qualitative, quantitative (e.g., score-based) or a combination of both.
- **Strategy Considerations:** There will be varying materiality of "E", "S" and "G" factors depending on the strategy, sector, and holding period of the product, amongst other considerations.

Research by MSCI[13], focused on equity and debt holdings, highlighted differences in the materiality of RI factors depending on time horizons and sectors:

- "G" aspects are more significant than "E" and "S" considerations over shorter time periods in terms of the impact on profitability, idiosyncratic risk, and systematic risk. This is because "G" is most directly linked to short-term events and incident risk.
- "E" and "S" indicators were more significant over longer time periods[14]
- "G" is particularly relevant in Financial and Consumer Discretionary GICS[15] sectors.
- "E" showed strong significance in the Materials and Energy sectors.
- Information Technology was more affected by human capital issues (part of "S").

This demonstrates that RI Integration needs to be flexible to allow asset managers to focus their research and risk management resources on the RI-related risks that are most financially material to the strategy.

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[13] https://www.msci.com/esg/deconstructing-esg-performance
[14] The study covered the period from 2006-2019.
[15] Global Industry Classification Standard jointly developed by Moodys and Standard & Poor's

The approach to RI Integration will also vary as a function of strategy, for example systematic funds will require integration of data in a different way to a strategy based on bottom-up fundamental analysis.

B2 Distinction from "Ethical" or "Socially Responsible" Investment

RI Integration is distinct from "ethical" or "socially responsible" investing which takes a position on the RI impact of the investment, rather than simply assessing the risk associated with RI-factors as part of a more holistic risk assessment. That said, RI integrated portfolios may include an RI tilt, for example if all other factors of two assets are equal (or within a set tolerance), then the investment decision could favour the asset that performs relatively better based on RI factors.

Appendix C
Responsible Asset Selection – Exclusions

RI-related exclusions aim to align investments with the investor's (or firm's) ethical values, religious beliefs, societal norms and/or principles[16]. Exclusions may be product-based using screening to exclude "damaging sectors" such as alcohol, tobacco, fossil fuels, or gambling. Alternatively, exclusions may be more dynamic, for example, based on either externally sourced or proprietary ESG ratings.

Exclusions do not consider the valuation or profit potential of an asset and this may mean that, if the investment universe would otherwise contain these excluded securities, the investor may forego returns where these industries or assets perform well.

C1 Effectiveness Challenges

Exclusions based on RI-related factors may be a simple and effective way for managers to achieve their or their investor's RI goals; however, there are also arguments that this may not be the most effective way to approach RI as discussed in the points below:

C1.1 Strategy Consideration

Typically, only trading of equity and debt directly influences the cost of capital for issuers (with some exceptions, for example where physical assets are used to hedge derivative positions). As such, exclusions may not be an effective tool for strategies trading other asset classes. The time horizon of the investment and direction of trading (i.e., long or short) also has implications on the effectiveness of exclusions. In multi-asset portfolios, consideration will need to be given to whether an exclusion list would apply to equities and potentially debt only, and perhaps only to long positions.

C1.2 Fiduciary Duty

Asset managers have a fiduciary duty to their investors. "Damaging Sectors" such as tobacco and fossil fuels may be purchased cheaply due to the move of capital away from these industries. This may mean they can provide higher returns than more "virtuous" industries. In addition, oil and gas companies have historically been good dividend payers and divestment from these securities may cause a loss of income in the short term.

C1.3 Binary Nature of the Decision

By its nature, an exclusion list is binary, a security is either excluded or it is not. Depending on how the exclusion list is determined (i.e., all stocks trading a certain product in a certain sector or based on relative scores and ratings versus peers) there may be little scope to appreciate nuances that could have a financially material impact. Examples of this might include companies that score poorly currently, but are

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[16] Note: All asset managers will be required to screen out investments prohibited by sanctions and other regulations, this section focuses on RI-related exclusions only.

making significant efforts to improve, or energy companies that may be best equipped to direct research into renewable energy.

C1.4 When “E” becomes “S”

Mass divestment of industries, such as fossil fuels, where there is not yet a reliable replacement, may have unintended social consequences. Aside from job losses that may be caused by scaled down operations, emerging markets are likely to be significantly affected. A coal or oil-based power supply in an emerging market may have life changing implications for its residents, including water sanitation and power to medical facilities. Exclusion lists do not allow for a nuanced view of individual companies that can weigh “social ills” against “social benefits”.

C2 Divestment versus Engagement

Divestment from companies or sectors for RI-related reasons is used by many large investors. It can result in an increase in the cost of capital for the company and act as an incentive for management to improve RI-related practices. It can also be argued that engagement can achieve the same outcomes. It may be the case that the combination of both is more effective with divestment being used as a last resort when engagement has failed.

C3 Investor Required Mandates

Investors may have regulatory reasons for providing an exclusion list, alternatively the list may be based on values or social beliefs (for example faith-based investing). This can be challenging if the exclusion list includes assets that would otherwise be part of the investment universe and may be detrimental to returns for other investors. In this case, it is likely that an SMA may be required, or an alternative method of P&L allocation employed to separate the returns from these securities.

Appendix D
Responsible Asset Selection - Inclusions (“Best in Class”)

Inclusions via “Best in Class” methodologies may include structuring portfolios by only allowing the top X percentile of securities in terms of ESG metrics, or by selecting securities without an RI lens and then overweighting those with relatively higher RI metric performance.

Examples of RI-related performance metrics that could be used to determine if an asset should be included in the investment universe may include external ESG ratings, greenhouse gas emissions, board independence and composition, gender diversity, human rights records, controversies, and many others.

The RI specific goals in the investment mandate will be important to justify selection of one security over another based on ESG ratings (or other criteria), in the event there is a sacrifice of financial returns.

D1 Crowding

There are concerns about crowding[17] that may be caused by investing based purely on third party ESG ratings or other similar criteria, particularly where there are large amounts of passive capital in indices that rely on vendor ESG ratings. This may cause over-valuation of these assets. Asset managers may need to include analysis of crowded trades within their risk management processes to ensure that this is not detrimental to the portfolio.

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[17] The convergence of investors on the same or similar stocks due to a tendency to focus on a similar set of factors.

D2 Alignment of Data with Objectives

In addition to general data challenges, a key consideration for inclusion strategies defining investment universes based on external ESG ratings, is that the ratings may not be aligned with the objective of the portfolio. As an example, many technology companies have high ESG ratings; however, some of them have also been accused of a lack of tax transparency and/or issues with working conditions. Asset managers will need to ensure that any due diligence on rating providers can demonstrate the methodology is aligned with the investment mandate.

D3 Effectiveness Challenges

Inclusions face many of the same challenges to effectiveness as exclusions, such as strategy considerations and the binary nature of decisions. The key difference is that inclusions (where the strategy holds equity or debt) allow for engagement with the company and the opportunity to generate further value from improvements.

Appendix E
Responsible Asset Selection - Inclusions (Thematic)

Thematic inclusion approaches define the investment universe by focusing on trends, sectors, or industries that the asset manager believes will provide returns, whilst also contributing to RI-related goals. Examples of this may include clean energy or investing in companies producing innovative solutions to world problems such as climate change and water shortages. This will differ to Impact Investing as it may not involve high levels of engagement or specific impact objectives. Outside of seeking to benefit from long term trends such as solar power, these strategies may seek to enhance these industries by providing capital to the relevant sectors.

E1 Resourcing

Depending on the theme of the portfolio, this RI Approach may be more resource intensive than relatively more simple exclusion or inclusion approaches based on ESG ratings. Additional fundamental research may need to be conducted to determine whether investments meet the investment mandate objectives.

E2 Effectiveness Challenges

There will be challenges to the effectiveness of this type of approach outside of resourcing. The type of asset class within the investment strategy may limit how effective the thematic inclusions are, for example investing via derivatives may not impact the underlying issuer's cost of capital. Investors should also consider some of the effectiveness challenges raised in Appendix D such as the potential for crowding.

Appendix F
Responsible Asset Selection – Impact Investing

Impact investing has similarities to a thematic inclusions policy, but there are differences. Impact investing will have the specific goal of delivering meaningful societal and environmental outcomes. This may involve investments in smaller or start-up companies and is likely to include higher levels of engagement.

Examples of impact goals could include contribution to the UN SDGs[18], improvements in specific areas such as carbon emissions or a more general goal of investing in companies with low ESG scores with a view to improving them through engagement.

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[18] United Nations Sustainable Development Goals https://sdgs.un.org/goals

F1 Risk of Greenwashing

Impact investments should be investments that generally would not be invested in outside of an impact mandate. Investing in companies that would have been mainstream investments prior to adding an impact filter may not fit this description. Managers should be wary of branding a product as “Impact” unless final investment decisions are made through an impact lens.

F2 Measurement

A key challenge in impact investing is the measurement of success, particularly relative to other managers offering impact products with the same goal. Whilst absolute returns will factor into any performance comparisons, it may be difficult for investors to assess the realised impact of one asset manager versus another. Defining ways to track this during the initial research and ongoing monitoring stages of the investment process will be crucial.

Appendix G
Responsible Ownership

G1 Voting

Voting rights are typically only granted to holders of direct equity and some debt positions. These rights allow voting on company resolutions, some of which may be related to RI factors, for example climate change. Asset managers typically approach votes in one of three ways:

- Abstaining from voting,
- Voting directly on each resolution (more suited to concentrated portfolios), or
- Outsourcing to third party proxy voting companies.

Asset managers (in strategies where this is relevant) should consider whether their proxy voting policies should also incorporate RI factors. For example, managers may choose to vote for environmental measures, or perhaps vote against executive compensation or board reappointments if RI-related targets are not met. Where voting is outsourced, managers may want to understand the third party’s stance on RI-related issues.

Outsourced voting is likely to be less nuanced than direct voting. With direct voting, votes on seemingly unrelated issues such as executive pay could be linked to RI-related targets. This may not be possible with outsourced voting. For portfolios with a large number of individual positions; however, a more practical approach may be to outsource the voting and define voting parameters on RI-related issues only.

Asset Managers may also want to consider whether they will disclose their proxy voting records to investors, particularly for dedicated RI products[19].

G2 Engagement

Traditionally responsible ownership has been viewed as direct engagement with the underlying issuer via methods such as voting and management meetings. It can therefore be viewed as exclusive to asset classes such as equity or debt. There are, however, other methods of engagement that can be used within all strategies, such as engagement with regulators, exchanges, industry bodies, investor groups or credit rating agencies. These methods of engagement may also be effective in pursuing RI-related goals.

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[19] Further details on Proxy Voting Policies can be found in the SBAI Alternative Investment Standards: https://www.sbai.org/standards/

G2.1 Direct Engagement:

For some strategies, particularly those with concentrated portfolios based on fundamental analysis, engagement with underlying issuers will be common within the investment process. Areas that cause concern and that may have a material financial impact will be discussed. As part of an RI Policy, engagement on RI-related issues can be added to this process.

G2.2 Collective Engagement:

Asset managers in all strategies are likely to be able to be involved in some form of collective engagement. For those that hold equity or debt positions, a collective effort may be undertaken with other holders to encourage or discourage certain practices.

Holders of other asset classes can still engage in collective engagement with regulators, exchanges, governments, industry bodies and other organisations, to encourage or discourage practices at an industry or sector level rather than a company specific level.

G3 Activism

Activism is a more involved or extreme form of engagement only available to relatively large equity holders with the resources and experience in this type of strategy. Activists will look to promote change through gaining board representation or building up a significant holding in the company. This strategy could be used to target a company with inferior RI credentials with the view to making improvements via replacing management or putting (sometimes public) pressure on management to improve these practices.

Appendix H
Responsible Corporate and Market Citizenship

H1 Organisational Initiatives

RI Policies can also include steps that have been taken by the firm itself to be mindful of E, S and G considerations. Investors will likely ask about the firm's efforts outside of its investment process as part of due diligence on RI Approaches.

The below section provides details on the types of initiatives that can be put in place.

H1.1 Environmental Initiatives

All companies have an impact on the environment around them and some steps can be taken to reduce this. Some examples of policies a firm could consider from an environmental perspective are detailed below:

Technology

The environmental footprint of technology used by the investment industry is not small and should not be ignored, particularly for more server-heavy strategies such as systematic strategies. An average user's email traffic generates 0.6 tonnes of CO_2 annually (just under half of an average person's emissions in India annually)[20] and total internet consumption accounts for more.

- Migrate servers to the cloud. Whilst it can be argued that this just pushes emissions from the firm to the cloud provider, in general data centres are now actively making use of renewable energies. Economies of scale also mean fewer overall servers can be used. Due diligence on data centres

[20] https://carbonliteracy.com/the-carbon-cost-of-an-email/

(and any other technology partners) is required and managers should understand the level of renewable energy used.

- Consider switching internet browsers to one that donates profits or focuses on reforestation.
- Use internal messaging tools where possible as they consume less energy than emails.
- Unsubscribe from emails you don't read or mailing lists that are no longer relevant.
- Avoid including people on email chains that do not need to be on the email by using targeted replies rather than “reply all”.
- Limit the number of short or potentially unnecessary emails such as “ok” or similar.
- Redundant hardware that needs to be disposed of should be either donated to a community initiative for re-use or recycled responsibly.

Travel and Meetings

- Reducing total amount of air travel - define essential reasons for travel, limit the number of people who can travel to the same meeting or other methods.
- Choose meeting locations that are local to all attendees where possible.
- Purchase carbon offsets. This requires an estimation of the carbon footprint caused by air-travel and managers will likely need to use external vendors to produce this estimate.
- Introduce responsible meeting practices - going paper-free, water refill stations (eliminating plastic bottles) and choosing a menu that features locally and sustainably sourced products.
- Understand where video conferencing is an appropriate replacement for in person meetings that require travelling. There will be some meetings that require site visits (for example due diligence on investments) but these should be limited to essential meetings with the minimum required number of staff.

Waste and Recycling

- Require recycling of non-confidential items, and contracts with confidential document shredders should include recycling.
- Limit the use of single use plastics (e.g., water or coffee cups).
- Reduce the need for printing e.g., digital storage rather than paper files (note that there may be some regulatory reasons for hard copies to be kept of certain documents, but these can be printed in black and white and double sided).
- Introduce separate recycling and general waste bins to encourage recycling.
- Reduce water wastage and consumption (and costs) by installing low flow plumbing fixtures and identifying and fixing leaks (where possible).

Energy Efficiency and Carbon Reduction

- Ensure that premises are energy efficient. Where the building is not owned by the firm (and thus these items are somewhat out of their control), demonstrate steps that have been taken to encourage the building owner to do this. Examples include energy efficient light bulbs, proper insulation, switching to a renewable energy supplier, and ensuring screens and lights are turned off each night.
- An energy audit (many utility companies offer them for free) can help identify more ways to save energy (and therefore costs).
- If possible, plant trees to absorb carbon dioxide either on the firm’s own land or as part of a community project.

H1.2 Social Initiatives

In recent years, the S in ESG has gained momentum. In general, businesses are not expected to stay silent or uninvolved with societal issues. Some examples of social focused policies that could be put in place are detailed below:

Treatment of Employees

There are basics enshrined in law, such as health and safety, but there are other areas of how well employees are treated including:

- Cultural elements such as ensuring employees feel valued and respected.
- Respect for employees' right to disconnect e.g., not expecting employees to respond to emails outside office hours or during vacation.

Culture & Diversity

This is a wide and evolving topic that will be covered in more detail in a separate SBAI initiative. Smaller firms may have more difficulties with some of these items (for example, mentoring schemes or employee networks); however, simpler items will be achievable.

- Consider diversity across the firm looking at Boards, Committees, and general staff to ensure that differing skill sets are represented and valued.
- Review internal processes such as recruitment, talent management, performance reviews and promotions to ensure they are set up in a way that encourages diversity in all its forms.
- Join industry associations or groups that are looking to help improve both culture and diversity at an industry level (for example by joining the SBAI's Culture & Diversity Group).
- Support initiatives by charitable organisations aimed at improving diversity.
- Building internal initiatives (proportionate to the size of the firm) including mentoring schemes, employee networks and returners programmes for women returning from maternity leave.
- Review and update pre-existing policies, such as parental leave, to ensure gender equality.
- Mandatory training to ensure all team members are aware of equality and diversity policies and that the tone is being set from the top

Charitable Contributions

- Firms can give directly to charities as well as encouraging employees to raise funds.
- Firms could offer a matching scheme where any donations raised by employees are matched by the firm.
- Non-monetary charitable contributions such as provision of facilities, time and skills of employees, old IT equipment, surplus meeting supplies, redundant office furniture and so on.

Community

- Encourage employees to volunteer their time to community organisations. This could be via providing paid leave that can be taken to volunteer or arranging for groups of employees to volunteer on behalf of the company.
- Throw community events such as Christmas parties for local children and tea and cake afternoons for the elderly to give back to the community.

Supply Chain Management

Firms will often be exposed to several different supply chains, everything from service providers to electricity to cleaning staff. Supply chain visibility is essential to delivering ethical practices and avoiding exploitation. A clear understanding of its suppliers' operations and the ability to access information (and make this accessible to partners and investors where required) on activities such as worker's contracts and conditions, environmental performance, financial processes, and provenance of materials is necessary.

- Policies could be put in place to complete detailed due diligence to ensure there are no human capital issues hidden in supply chains.
- Conscious efforts could be made to source certified sustainable products, engage with sustainably leading consultants and encouraging current suppliers to set sustainable goals.

Health and Wellbeing Benefits

Employers can ensure that a good standard of health and wellbeing benefits are available to staff. This can include:

- Facilitating access to private medical insurance (either via direct provision or monetary contributions).
- Providing access to general health and wellbeing tools and services aimed at improving mental health and general wellbeing. This area became increasingly important during the prolonged remote working period in 2020 and into 2021.

H1.3 Governance

Governance has long been a focus of asset managers, regulators, and investors alike. The SBAI Alternative Investment Standards have a strong focus on the governance of procedures within an investment management firm. Some examples of areas covered by Governance are:

- Transparency – ensuring this is instilled as a culture within the firm.
- Code of Ethics (or equivalent for a non-SEC registered firm).
- Strong policies and procedures e.g., background checks, financial crime, disaster recovery, cyber security, and others.

H2 Good Market Citizen

Being a responsible investor is wider than the selection of the investment universe – it applies to how investors act in the market regardless of asset class or investment style. Asset managers should look to contribute to reliable and fair markets.

Having strong policies and controls in place on areas such as MNPI, Market Abuse and Personal Trading, can help demonstrate a firm's commitment to being a "good market citizen". Asset managers should also be aware of the role they have in the marketplace and the impact trade execution can have on market functioning.

H3 Carbon Hedging

This is the process of calculating the extent that a portfolio (or firm) is funding emissions and then purchasing offsets of the same amount, for example by purchasing carbon credits and perhaps taking them out of circulation so they can no longer be used to produce emissions.

There are two sources of carbon credits and a firm would need to consider which would be the most appropriate:

- Voluntary carbon credits which are created by climate-friendly projects. These are sold by small consultancies and brokers and are typically produced in the developing world and sold in more developed markets.
- Compliance related carbon credits which are typically excess credits sold by firms that are participating in highly regulated regional or global programs such as the EU Emissions Trading System and the UN's Clean Development Mechanism.

H3.1 Methodology Challenges

Carbon emissions are challenging to measure and would require data on Scope 1 and Scope 2 emissions at a minimum (a lot of current metrics do not account for Scope 3 emissions)[21]. A metric to measure this must be chosen (for example TCFD uses the Weighted Average Carbon Intensity[22]), most metrics have limitations and may not be designed for use in the specific strategy or asset class.

Pricing of carbon credits is still relatively unstable and inconsistent. This makes using carbon credits accurately as a hedge difficult until there is critical mass in the market. Over time (particularly with support from the new US Administration) this is likely to change and a more stable market allowing efficient pricing may arise.

Shorting of securities presents a challenge that the asset manager would need to both consider and determine a methodology for. Should the carbon emissions of short investments be deducted from the carbon emissions for the long portfolio or should they be excluded from this calculation as no direct funding is being provided. Either way the asset manager should be prepared to explain its approach and the rationale for it.

H3.2 Effectiveness Challenges

There is a question over whether hedging carbon emissions within a portfolio is really changing any behaviour i.e., is it allowing firms to be able to pay to “absolve” themselves of these emissions without making any fundamental changes in their investment process or investment universe?

A counter argument to this is that putting a price on the carbon emissions generated by investments (i.e., by having to pay for offsetting carbon credits), may increase pressure internally to reduce the amount of emissions funded to reduce the cost to the firm (note that this would not necessarily be the case if the fund pays for the carbon credits; however, investor pressure would likely have the same effect).

Appendix I
Oversight of the RI Approach

Depending on the structure (and size) of the organisation and the specific type of RI Approach being followed, there are several ways to approach this. Firms may have dedicated RI resources either within a separate team or embedded within the investment team, and these resources may or may not be overseen by a form of committee. Regardless of approach, there are a few important things that should be in place:

- There should be a dedicated senior individual or team that is responsible for the governance of the policy.
- Where the asset manager runs a dedicated RI product, a senior individual or team should be responsible for ensuring investments are in line with this investment mandate in a measurable way.
- Any resources with RI responsibilities should be provided with the appropriate amount of training for their role.

Asset managers may choose to structure this oversight in one of the following ways:

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[21] Scope 1 is All Direct Emissions, Scope 2 is Indirect Emissions from electricity and Scope 3 is all other Indirect Emissions (e.g., business travel, procurement, waste, water etc.)

[22] Since companies with higher carbon intensity are likely to face more exposure to carbon related market and regulatory risks, this metric indicates a portfolio's exposure to potential climate change-related risks relative to other portfolios or a benchmark

RI Committee

Given the overlapping nature of RI with all the separate teams detailed below, it may be suitable for an asset manager to form an RI Committee to oversee the policy. This committee could be made up of representatives from various teams including:

- Any dedicated RI teams,
- Investment team,
- Compliance, and/or
- Investor Relations.

A committee structure may be effective for larger organisations or where responsibility is split over more than one team. This will ensure there are both decision makers and people to communicate the strategy and policies to the relevant teams.

Alternatively, the asset manager may choose to dedicate one of the specific teams below to have oversight of the policy:

Dedicated RI Team

Some firms will create a dedicated RI team that will be responsible for the policy. Responsibilities of this team may include:

- RI-related due diligence,
- Definition of the investment universe (if applying RI filters), and/or
- Monitoring and measuring of any RI product goals.

Preferably this team should have close interactions with the Investment Team to ensure any RI philosophy is consistent across the investment process. In jurisdictions where there are regulatory requirements[23] relating to RI, the team will likely have to work closely with the compliance function also.

Dedicated RI teams can provide synergies of scale including helping to manage policies such as proxy voting and engagement (if applicable). Dedicated teams will not necessarily be practical for smaller asset managers.

Investment Team

The responsibility for oversight of the policy may sit with the Investment Team to ensure it is integrated within the investment process. This may be achieved by having dedicated research analysts focusing on specific RI areas sitting within the Investment Team and contributing to any analysis.

Firms will need to ensure that either resources with the dedicated skill sets are hired into the team or proper training on the relevant RI factors is introduced.

Investor Relations/Sales/Client Services

Firms may choose to have a client facing team overseeing this policy. There is some caution to be taken in this approach. Where RI seems to be primarily the responsibility of a client facing team it may be viewed by institutional investors as more of a marketing policy than truly integrated within the firm. That said, it is important that any client facing staff can accurately articulate the philosophy and practical implementation of the RI Approach to investors.

[23] See the SBAI Memo on Regulations for a summary of these requirements: https://www.sbai.org/wp-content/uploads/2020/10/ToolBox-Memo-Responsible-Investment-Review-of-Regulatory-Expectations-Final.pdf

Compliance Team

Compliance teams may oversee the policy to ensure compliance with any stated aims of the policy and monitor and measure goals on RI Products. It is likely to be preferable that this responsibility is shared with the Investment Team to demonstrate full integration across the investment process.

Training

RI training should be embedded within the teams responsible for RI, whether they are dedicated teams or when RI sits within an existing team. The frequency of this training may depend on how material RI-related processes are to both the strategy and the investment mandate.

Whilst training may be more straightforward for E and G factors using available metrics and fundamental analysis, it can be harder to develop knowledge and training on the social side.

Internal training can be focused on ensuring all staff understand the objectives of the RI Policy and external consultants may be used for explaining what RI integration means and sharing best practices.

Appendix J
Additional Resources

This appendix provides links to additional resources on:

- Regulatory and Industry Body Guidance
- RI Integration
- Engagement
- Impact Investing

J1 Regulatory and Industry Body Guidance

For a more detailed overview of this please see the SBAI's Memo on the Regulatory Environment for Responsible Investment.

Organisation	Description	Link
The European Commission	Overview of EU requirements for Non-Financial Reporting (including ESG) from large companies	EC Non-Financial Reporting
UN Principles for Responsible Investment (PRI)	Page contains links to information on RI in Hedge Funds and other asset classes	UN PRI Investment Tools – Alternative Investments
UN Principles for Responsible Investment (PRI)	• Actions managers can take in the area of governance (incl. signing up to the SBAI Alternative Investment Standards) • Consideration of relevant ESG data in investment process • Concept of active responsible ownership • Risk and benefits of certain hedge fund investment techniques (shorting, leverage) • Communication of approach	UN PRI – How to Apply Responsible Investment to Hedge Funds
Alternative Investment Management Association (AIMA)	Focus on what asset management firms can do at management company level in terms of ESG	AIMA – Policy and Practice ESG Considerations at Alternative Investment Management Firms
Alternative Investment Management Association (AIMA)	Guidance on content of a RI Policy (Preamble, RI organisation structure, policy on exclusions, ESG integration, policy on stewardship)	AIMA – Responsible Investment Policies for Hedge Fund Firms

UK investment Association	• Categorisation of RI Approaches (Page 11) • Help savers compare funds with focus on environmental or social outcomes. • UK retail product label (for further exploration)	Industry Wide Common Language brings Clarity to Responsible Investment
Council of Institutional Investors (CII)	Comparative review of four ESG frameworks: The Carbon Disclosure Project (CDP), the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB) and the Task Force on Climate-related Financial Disclosures (TCFD).	Sustainability Reporting a Guide for CIOs
Sustainability Accounting Standards Board	Review of SASB standards use cases in every phase of private market investment, from due diligence to management and monitoring, to reporting—both from portfolio companies to general partners (GPs) and from GPs to limited partners (LPs).	SASB and Private Markets
EMSA	The two final reports contain technical advice to the EC on the integration of sustainability risks and factors, relating to environmental, social, and good governance considerations with regards to investment firms and investment funds, into the Markets in Financial Instruments Directive II (MiFID II) (investment services), the Alternative Investment Fund Managers Directive (AIFMD) and the Undertakings in Collective Investment in Transferable Securities (UCITS	ESMAs Technical Advice to the EC on integrating sustainability risks and factors into UCITS and AIFMD
CFA Institute	An overview of the background, the application and the discussions around ESG issues & integration within the investment industry	Environmental, Social and Governance Issues in Investing: A Guide for Investment Professionals

J2: RI Integration

Organisation	Description	Link
PRI	A Technical guide to incorporating ESG into Hedge Funds	Technical Guide
CFA Institute	Applying ESG integration is consistent with an asset manager's fiduciary duty. The Statement supports the development of a proper taxonomy that requires full disclosure and validation of any ESG investment	Positions on E, S and G Integration

J3: Engagement

Organisation	Description	Link
Financial Reporting Council	UK Stewardship Code January 2020	Code
SASB	Industry-by-industry guidance on how asset owners and asset managers can use the SASB standards to inform and enhance their engagement with companies	Engagement Guide for Asset Owners and Asset Managers.
SFC (Hong Kong)	Voluntary principles on Responsible Investment to assist investors to determine how best to meet their ownership responsibilities	Principles of Responsible Ownership
Investor Stewardship Group	Principles for Stewardship	Stewardship Principles

Japan FSA	Japan's Stewardship Code	Principles for Responsible Investment

J4: Impact Investing

Organisation	Description	Link
Impact Principles	The Impact Principles, launched in April 2019, provide a framework for investors to ensure that impact considerations are purposefully integrated throughout the investment life cycle. These 9 principles bring greater discipline and transparency to the impact investing market, requiring annual disclosure statements and independent verification of Signatories' impact management systems and processes.	Impact Principles
Global Impact Investing Network	Industry network for Impact Investing including education materials	GIIN
UN Sustainable Development Goals	Framework used by some impact investors to assess investment opportunities against high level objectives	UN SDGs

Appendix K
SBAI RI Working Group Members

The following members were part of the sub-stream within the SBAI's RI Working Group that contributed to the production of this memo.

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