www.binarycapital.co.uk

Binary Capital Investment Management

Binary Capital Investment Management

Whitepaper

Exploring Responsible Investing with Binary Capital IM

November 2021

Long-termism shapes our relationships and our investments

Exploring responsible investing with Binary Capital Investment Management

Authored by:

Saftar Sarwar
Chief Investment Officer

Amir Miah
Junior Portfolio Manager

Nicholas Todd
Investment Analyst

Introduction

Environmental, Social and Governance has become an integral consideration within the investment management industry, significantly growing in importance over the past decade. Not a day goes by without another research paper or note being released highlighting the latest product, strategy or 'ESG vision'. The so-called 'bubble' in ESG investing needs to be properly deciphered and a greater understanding of the area is required to truly appreciate the opportunities it can provide for investors. ESG investing is not a one size fits all strategy, there are nuances and many debates continuously developing. Ultimately, we always invest for clients within our own ESG framework and policies.

At Binary Capital IM we have both a considerable interest and experience in optimising the management of investment strategies in the responsible investment space, alongside genuine strong performance to underline our expertise in this area. Understanding, executing and delivering performance; a winning combination.

In this note we have set out to explore ESG from an intermediary perspective to gain a refreshed understanding of optimal sustainable strategies for our 'genuinely active' investment philosophy, as well as exploring the foundations to define what we consider to be the core philosophy to ESG investing.

Financial advisers and wealth managers may find interest in this paper through:

- Understanding the different styles of responsible investing.
- Understanding a variety of ESG integration processes that portfolio managers may use in practice.
- The trends of positive impact investing in liquid equities.
- Understanding how one can construct genuine active ESG portfolios for clients.

Contents

Disclaimer: The Information in this document is not intended to influence you in making any investment decisions and should not be considered as advice or a recommendation to invest. Any Information may not be suitable for all investors and investors must make their own investment decisions using their own independent advisors and relevant offering material.

Capital at risk. Please review full disclaimer.

PART 1:

The rise of responsible investing

Over the past 20 years responsible investing has been a growing area within the investment management industry. The area is now viewed as essential for managers to understand and incorporate into the decision-making process. A truly mainstream investment topic with a flurry of new products and types of investment strategies on offer. A new strategy delivered every day.

There are several reasons for the increasing demand to manufacture and invest in responsible investment collectives including:

- Academic studies suggesting that integrating ESG factors into the investment process can lead to returns similar to or even *in excess* of those generated by conventional investment solutions. There is much debate around this.
- Societal trends and values – increasingly influencing consumer choices.
- A shift to longer term investment and investment strategy thinking.
- Increased interest in climate and other environmental factors.

However, the terminology, definitions and methodologies used by practitioners vary widely. There are many labels used by product providers such as 'ethical', 'sustainable', 'ESG', 'SRI' and 'impact' with inconsistencies with how the labels are used to describe the investment strategies.

We view responsible investment as the 'best fit' overarching term that covers all styles (in line with the thinking of others such as The Investment Association (2019))[1]. However, we note that ESG has become an industry shorthand for a cover all term. It is a very popular acronym so for simplicity we also use the term ESG in the same manner.

The issue of common taxonomy for strategies and approaches is likely to remain in the near term until the industry finds a consistent and common language. For this reason, it is important that wealth managers and advisers have their own clear definitions based on their independent thinking or through industry leading leadership from bodies such as The Investment Association (IA) or Global Impact Investing Network (GIIN) for impact investing.

[1] *https://www.theia.org/sites/default/files/2019-11/20191118-iaresponsibleinvestmentframework.pdf*

We catergorise funds using six distinct approaches to responsible investment. We take a practical approach to the taxonomy task linking with our knowledge of available investment products.

Table 1: Styles of Liquid Responsible investments

Responsible Investment

Name	Description	Investment styles
Negative screening / Exclusionary / Faith-based / Ethical	Simple exclusionary investment strategy. Excluding harmful companies & companies engaged in activities deemed unethical. Exclusions can also be based on religious beliefs.	Active & Passive
ESG integration	Integration of material Environmental, Social and Governance factors into the investment process to manage risk and performance in addition to exclusionary strategy.	Active & Passive
Inclusionary – Best in class ESG / ESG tilted / Socially responsible investing	Investing in corporates with better ESG characteristics; applying environmental and social criteria when evaluating companies. A focus on operational characteristics of corporates which are often aggregated as scores, therefore leading to investment in those with higher absolute or relative scores rate i.e., investment only in top 25% scored.	Active & Passive
Thematic Approach	A focus approach on specified themes. i.e., clean energy, water & education.	Active & Passive. More active
Sustainable Investing	Investing that creates long-term social, environmental and economic value; non-financial and financial value creation. Investing in alignment for sustainable development. For example, aligning investment selection with UN SDGs. This approach may include an exclusionary approach, ESG integration approach and best in class ESG selection approach.	Active
Positive impact	Investing in corporates which have core products or services that generate a measurable & visible positive impact. Consistently measurable.	Active & Passive. More active.

Going Further

What is ESG investing?

ESG stands for Environmental, Social and Governance. An ESG investment strategy applies such non-financial factors into the investment process to identify and manage material risks that may affect risk and return.

PART 2:

Passive approach to responsible investing

There are key differences between active and passive ESG strategies that will have a direct effect in meeting client objectives. The common feature amongst passive ESG strategies is that they take a quantitative approach to investment decision making; the underlying index often utilising 3rd party scoring engines for selection and tilting portfolios. A computer driven strategy.

Understanding Passive ESG

Passive ESG funds are usually based on ESG indexes. There are 1,000s available[2]. To understand how Passive ESG works it is essential to understand the methodology of the index that is being tracked.

ESG index construction typically begins with a global parent index that includes the initial investment universe. The investment universe is then 'narrowed' by applying defined ESG filters such as negative screening or thematic filters. Finally, the index is constructed from this universe using the defined index rules.

Some of the factors that can differ between products include:

- Negative screening criteria (exclusions)
- The ESG data availability and scoring provider(s)
- The ESG data points considered
- Algorithm for weighting allocations
- General characteristics of the index including market cap size focus, sector weights, country weights and factor exposures
- Active ownership approach by asset manager(s)

Within the Passive approach, ESG is incorporated through exclusionary criteria and/or thematic filters, and ESG inclusionary/best-in-class approaches via company ESG scoring. ESG scoring is often used for inclusionary criteria as well as for investment portfolio tilting. Asset managers will differ in their active ownership approaches through their engagement with companies, proxy voting and putting forward shareholder proposals.

An elusive part of the index construction process is the ESG scoring. There are concerns from some industry practitioners around the heavy reliance on scoring outputs from ESG data providers such as MSCI and Sustainalytics (Morningstar). The data providers use opaque scoring methodologies, proprietary estimated/modelled data, and subjective ESG materiality weights. Furthermore, the methodologies used by different data providers and their respective outputs have been widely noted as highly inconsistent, and between providers there is a low cross-sectional correlation of scores[3]. We also note that company disclosure data globally is still poor, with many corporates not disclosing key data points such as Scope 3 GHG emissions which can skew scoring results.

[2] https://www.ussif.org/files/Publications/Rise_of_ESG_%20passiveinvestments_2020.pdf
[3] Abhayawansa, S. and Tyagi, S., 2021. Sustainable investing: The black box of environmental, social, and governance (ESG) ratings. *The Journal of Wealth Management*, *24*(1), pp.49-54.

Figure 1: Examples of common datapoints for ESG data analytics and scoring

Environmental

Category	Example Data points
Climate change and carbon emissions	• Disclosures of Green House Gas (GHG) emissions from Scope 1, 2 and 3. • Climate Change Policy • Temperature scores
Air and water pollution	• Air Pollution Reduction Policy • Total water recycled
Energy efficiency	• Energy usage • GHG/CO2 Intensity per sales
Waste management	• Water Policy • Water usage
Biodiversity and deforestation	• Biodiversity Policy • Environmental Supply Chain Management Policy • Animal Welfare Policy

Social

Category	Example Data points
Gender and diversity policies	• Percent of women employed (trend data) • Community engagement policy /spending
Safety, quality controls & Labour standards	• Health & Safety policy • Anti bribery ethics Policy • Policy against child labour • Lost time per employee
Human rights	• Human Rights Policy
Privacy and data security	• Employee protection Whistleblower Policy • Anti-bribary Ethics score
Employee engagement	• % Employee turnover • Number of part-time employees • Average employee training hours

Governance

Category	Example Data points
Board composition	• Percent of non-executives
Management Diversity	• Percent of women on the board (trend data) • Board average age
Shareholders' rights	• Poison Pill Plan • Percent of shares held by executives
Remuneration	• Percent of non-executive directors on compensation committee • Clawback provision for executive compensation
Audit and oversight	• Years auditor employed • Independent audit committee chairperson

Table 2 provides some examples of passive ESG products. As part of the index construction methodology, ESG ratings play a significant role in security selection and weighting for some indexes. Although we recognise the role of ratings providers as a useful data point, we see this as problematic when building live investment strategies based on scoring outputs. The primary reason for this is due to the lack of transparency issue and how data providers interpretations differ when defining what is good and what is bad. We are left asking is this a genuine ESG strategy? The transparency issue will likely remain for the foreseeable as the intricacies of the scoring process are seen as intellectual property for the data providers. ESG ratings should be used with caution as one of many inputs into the decision-making process.

Table 2: Examples of Passive ESG products

Product Example	Index tracked	Negative Screening	Other points
Example 1: Amundi Index MSCI World SRI -100% MSCI World SRI Filtered Ex Fossil Fuels	MSCI World SRI Filtered ex Fossil Fuels Index (Total return index)	• Nuclear Power • Tobacco • Thermal coal • Alcohol • Gambling • Military Weapons • Civilian Firearms • GMOs • Adult Entertainment • Fossil fuel production & reserves	• Min ESG ratings • Min ESG controversy scores • Selecting 25% of best-in-class ESG score in each sector • Max weighting of 5% in any stock
Example 2: iShares MSCI World SRI UCITS ETF	MSCI World SRI Select Reduced Fossil Fuel Index	• Controversial Weapons • Civilian Firearms • Nuclear Weapons • Tobacco • Alcohol • Adult Entertainment • Conventional Weapons • Gambling • Genetically Modified Organisms • Nuclear Power Climate change-based exclusions: • Thermal Coal Mining • Unconventional Oil & Gas Extraction • Oil Sands Extraction • Conventional Oil & Gas Extraction • Thermal Coal-based Power Generation • Oil & Gas-based Power Generation • Thermal Coal Reserves • Oil Sands Reserves	• Min ESG ratings • Min ESG controversy scores • Selecting 25% of best-in-class ESG score in each sector • Max weighting of 5% in any stock
Vanguard ESG Global All Cap UCITS ETF	FTSE Global All Cap Choice Index	• Nuclear Power – Generation and Uranium Mining • Fossil Fuels – Coal, Oil & Gas • Adult Entertainment • Alcohol • Gambling • Tobacco • Weapons	• Exclude controversies around Anti-corruption, Environment, Human Rights, Labor
iShares MSCI Global Impact ETF (US listed – USD priced only)	MSCI ACWI Sustainable Impact Index	• Tobacco • Alcohol • Predatory lending • Controversial Weapons • Nuclear Weapons • Conventional Weapons • Civilian Firearms	• Revenue-based weighting • MSCI BB or more ESG rating only • Only companies that have more than 50% revenues from defined themes • MSCI controversy score

How are active managers integrating ESG?

There are many general investment styles, so for simplicity and focus, we concentrate on active long-term strategies. Here we provide some examples on how such managers that follow this investment style integrate ESG explicitly and implicitly into their strategies, and the tools that they may use.

Negative/exclusionary and norms-based screening

Negative screening is the exclusion of certain sectors, companies or practices based on specific ESG criteria or avoiding harm. Norms based screening is screening for minimum standards of business practice around international norms.

Active managers are using negative screening on their initial investment universe based on set criteria to filter down to their investable universe. This avoids investment in companies that do not meet minimum standards and/or create significant negative externalities.

Materiality

Core to the integration of ESG in any investment process is locating and understanding the material issues that affect industries and individual corporates. Active managers are integrating ESG by building an understanding of materiality, a term borrowed from the accounting and auditing profession. Materiality can be broadly defined as "*material information that is capable of making a difference to an evaluation process*", and more specifically for the investment case, *"understanding why and how specific factors could have a major impact on the stock performance of a company*".

ESG factors, particularly ESG related scandals can significantly impact the performance of the stock performance of a company, with a vast literature on the subject as well as many real-world cases i.e., Volkswagen (VW) emissions scandal, BP Deepwater oil leaks, Wirecard and Boohoo for supply chains. Some investors adjust forecasted financials based on material ESG factors and credit investors may adjust default risks or proprietary credit ratings (UN PRI, 2016).

Naturally, some sectors will have more high impact material risks, for example, oil and gas extraction and fast fashion retailing. When things go wrong, they can go significantly wrong, share price will be negatively impacted, and therefore negatively affect the overall portfolio performance.

Bodies such as the Sustainability Accounting Standards Board (SASB) have been key in driving the focus on materiality through materiality frameworks. There are a range of sub-issues associated to sustainability that the SASB have categorised under Environment, Leadership and Governance, Business Model and Innovation, Human Capital and Social Capital. The sub-issues are mapped to sectors and highlighted with a level of material risk – low, medium or high. Active fund managers are integrating the work of bodies such as the SASB and utilising proprietary materiality frameworks.

Third party ESG Rating providers use the concept of materiality to focus on the key metrics on what is material to include in an ESG score for a corporate. There are judgements that need to be made on how to weight such material factors.

By looking from a purely quantitative perspective, underlying material risks may be missed. As a result of the complexity and variety of sustainability issues, a good fundamental understanding of a corporate is required to have a detailed understanding of the ESG risks and opportunities, and the management of those risks and opportunities by corporate management. Fundamental investment analysis is still key.

ESG scoring

Active managers are utilising third party and proprietary ESG scoring as an initial data point/screening when looking at an investment. For example, the screen highlights companies where there may be high ESG risk by using an ESG quant provider such as RepRisk which uses alternative data such as news sources.

ESG laggards may be excluded from investment based on scoring or may give reason to investigate further. This is essentially a first stage screening tool.

Methods focused on climate risk and the transition to a low carbon economy

1. Carbon footprinting

Asset managers are reporting their portfolio carbon footprint on factsheets. Carbon footprinting is a traditional approach to assessing climate risk within investment portfolios. It involves looking at the carbon footprint of companies through scope 1, scope 2 and scope 3 GHG emissions output. However, this measurement can be prone to data availability issues such as low company disclosures in countries such as the US, particularly around scope 3 (indirect) disclosures.

Investors with the knowledge of their portfolio carbon footprint may tilt towards lower polluting corporates, exclude heavy polluting industries and corporates, or aim to maintain a carbon footprint below their benchmark.

Investors are using the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD). The TCFD is a body set up in 2015 that designed a set of voluntary recommendations for consistent disclosures related to climate risk. Investors can typically follow the methodologies of the TCFD to disclose consistent and comparable data.

2. Transition to a low carbon economy

Climate change is a material risk that directly or indirectly affects all industries as we transition towards net zero economies. As a key material risk, fund managers are indicating a special focus on climate change. In line with international and national agendas, governments should strive to limit global warming to well below 2 °C or 1.5 °C above pre-industrials level, which is referred to as the Paris Agreement.

More thoughtful investors are taking a forward-looking approach to climate risk analysis, analysing the science-based trajectory their current portfolio would take to 2050 as a benchmark date. Science-based trajectories convert emissions output into a temperature score which is used to present a glidepath of the portfolio to 2050. Through knowing their climate trajectory, fund managers may make changes to their portfolio or engage with investee companies to align better with these objectives.

Furthermore, fund managers are integrating thinking around a 'just' transition. It is a transition, and it is important to consider the negative social externalities this will have, for example, many individuals will lose their jobs.

From a fundamental perspective investors are understanding climate risks – transition risks and physical risks and seeing corporates' pathway/ preparedness to operate/ move into a low carbon economy. Typically, investors could:

- Judge how the board and management are considering the risks and how they are adjusting to address such risks and opportunities.
- Is the company assessing their current emissions and setting targets – working towards net zero.
- How the company is participating in discussions around policy making. How reactive is the company?

Some fund managers are solely focused on investing in innovators that address the demands within a low carbon economy.

Linking equities to the UN Sustainable Development Goals (UN SDGs) and thinking thematically.

There is an increasing trend of asset managers launching liquid equity funds that are marketed as being aligned to United Nations Sustainable Development Goals (UN SDGs). Fund managers are linking their portfolios to the UN SDGs using proprietary methodologies and third-party data vendors; providing investors with a view to which targets their capital is invested towards. Fund managers are categorising single name equities to impact or sustainability themes (see table 3 below) which are often underpinned by UN SDGs.

We view these as positive developments both from an ESG perspective and from an investment performance perspective. Looking through a thematic lens provides more clarity around such thematic exposure from a values perspective and can aid thematic diversification for better constructed portfolios. However, this is caveated by the categorizations being proprietary as there is no universal approach, so comparability remains an issue (see table 3). We hope to see the industry move towards universal frameworks for sustainability and impact theme reporting, leading to improved data aggregation and client reporting by intermediaries. A consensus is required and very much needed.

Table 3 – Examples of sustainability and impact themes

Fund Name	Sustainability/Impact Themes
ARTEMIS The Profit Hunter **Artemis Positive Future Fund**	• Clean Tech • Circular Economics • Consumption Reduction • Disaster Recovery • Healthy Healthcare • Including Wellbeing • Entrepreneurship • Financial Security
BAILLIE GIFFORD **Baillie Gifford Positive Change Fund / Keystone Positive Change Inv Trust plc**	• Social Inclusion And Education • Environment And Resource Needs • Healthcare And Quality Of Life • Base Of Pyramid
BINARY CAPITAL Investment Management **Binary Capital – Sustainable MPS**	• Circular Economy • Renewable Resources • Sustainable Transportation And Infrastructure • Sustainable Food And Agriculture • Sustainable Innovation / Enabling Sustainable Innovation • Energy Efficiency & Green Buildings • Health And Wellbeing • Social And Financial Inclusion, Education And Empowerment • Water Management
M&G Investments **M&G Positive Impact Fund**	• Climate Action • Environmental Solutions • Circular Economy • Better Health, Saving Lives • Better Work And Education • Social Inclusion
MSCI **MSCI ACWI Sustainable Impact Index**	• Nutritious Products • Treatment Of Major Diseases • Sanitary Products • Education • Affordable Housing • Loans To Small And Medium Size Enterprises • Alternative Energy • Energy Efficiency • Green Building • Sustainable Water • Pollution Prevention

PART 4:

Positive impact investing with liquid equities

Positive impact liquid investing should be seen differently from 'impact investing'. The latter is typically associated with private equity where impactful goals are targeted together with investment returns. Such impact goals can include energy coverage, movement away from poverty and female employment utilization. We see positive impact liquid investing as a strand of sustainable investing, with the added activity of measuring and monitoring the amount of positive change generated by an investors' activity. Historically, it was believed that such style of investing required giving up financial returns for social returns. This no longer needs to be the case.

The general foundation for positive impact investing, is providing an opportunity for investors to achieve clear and measurable environmental or social return without compromising on financial returns. Companies within a positive impact fund are suggested to have intentionality, materiality and additionality to tackle environmental or social issues and/or demonstrate they are addressing the need for progression in these areas through their core products or services.

This is different to ESG investing in the conventional sense. Positive impact is associated with core product or service solutions that directly contribute to improvements for people and the planet, whereas ESG has a focus on operational characteristics of corporates. It is important to note that impact assessment and measurement are still in their early stages.

Intentionality, Materiality and Additionality

A simple framework used by investors focuses on intentionality, materiality and additionality.

The framework allows investors to better judge if there is currently an impact being generated or if there will be impact generated by a corporate in the future. This is combined with the potential scale of that impact and the quality of the impact that will be delivered.

The framework provides investors with a quick and simple way to judge whether there is a link to impact objectives or not. We hope to see fund managers outlining their thinking on all fund holdings, outlining how corporates meet the intentionality, additionality and materiality criteria within their sustainability/impact reports.

INTENTIONALITY

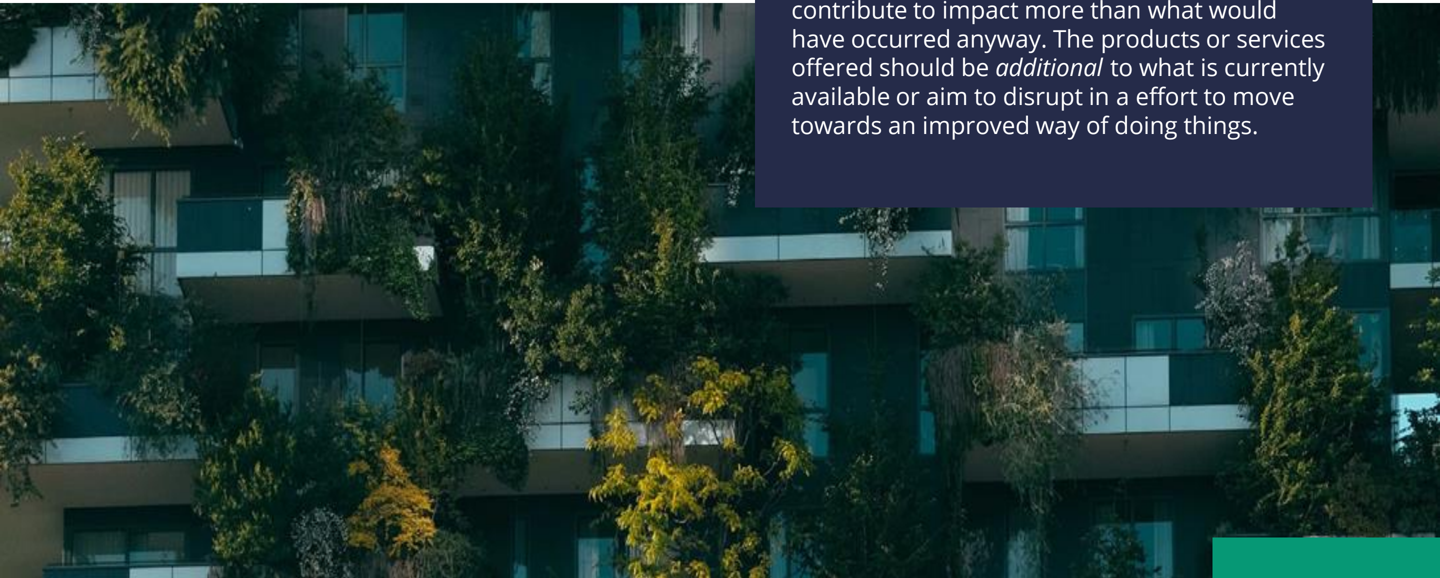
The *intention* of a company to exert a positive social or environmental impact through their core product or services. Companies should be authentically dedicated to positive impact on people or the planet through their mission, objectives and culture.

MATERIALITY

How significant the impact is and how significant it could be through the core products and services offered by a corporate. The products or services offered should make a *significant* contribution to defined impact objectives.

ADDITIONALITY

If the core products or services offered contribute to impact more than what would have occurred anyway. The products or services offered should be *additional* to what is currently available or aim to disrupt in a effort to move towards an improved way of doing things.



Quantifying positive impact as output

Asset managers are reporting impact statistics that are generated by an investment holding and distilling those impact statistics by an investment amount such as £1m or £100,000. For example, equity A contributed to disease prevention for *X* number of people, or £1m invested in the portfolio treated *X* number of patients.

Often it is difficult to precisely quantify the direct impact of corporates. This becomes very difficult when investors use funds as you are aggregating often hundreds of underlying companies. Furthermore, there is no indication to the quality of the impact when distilled into clean quantitative measurements.

Theory of change

The theory of change is a causal impact model widely used by charities, social enterprises, and social investors. The model has most recently found its way to liquid equity investors. Simplistically, the model provides clarity around the chain links from inputs (resources of corporates), activities (what the corporate does), shorter-term outputs of a corporate (the core products or services produced), outcomes (the short-term impact produced) and the impact expected over the long-term.

The model will vary when used for reporting to investors from the way the model could be used for organisations and investors for planning and strategy setting. Through clear conceptual links to long-term impact objectives, the model promotes improved monitoring and measurement of the impacts over time.

At Binary Capital, we see fund managers utilising the theory of change as further evidence of the *intentionality* of these fund managers to deliver a genuine impact strategy. It provides us with a better understanding of the thought process around how managers view corporates links to long-term impact objectives.

Figure 2 provides an example of a basic theory of change framework that could be applicable for liquid equity investors when reporting.

Figure 2 – Example of theory of change adapted for liquid equities

moderna

Inputs Capital & Human Capital	1800+ Employees & $175 Billion Market Cap (as at 22.09.2021)
Activities What does the corporate do?	Moderna develops vaccines and treatments for a wide range of diseases including cardiovascular conditions, cancer and rare diseases. It uses a technique which synthesises molecules that can be injected into patients to help their bodies create their own therapies to the infection.
Outputs Production or delivery of core product or service by the corporate. This should be in numbers of.	Moderna has 24 development programs, of which 13 have entered clinical studies. Moderna as of 19th September 2021 has delivered around 150m Covid-19 vaccine doses (Statista.com).
Outcomes Short-term/intermediate-term outcomes generated as a result of the activities and outputs of the corporate. This should be quantified.	A large 2020 trial, involving 30,420 adult volunteers at various sites across the U.S., reports that the Moderna vaccine has a 94.1% efficacy rate against COVID-19, including against severe disease. The vaccine has improved patient outcomes significantly against COVID-19.
Impact / Long-term objectives What is the long-term change/impact that the corporate will produce. This could be UN SDGs or other defined goals.	**Good health and wellbeing – Target 3.3:** By 2030 end the epidemics of AIDS, tuberculosis, malaria and neglected tropical diseases, and combat hepatitis, water-borne diseases and other communicable diseases **Target 3.8:** Achieve universal health coverage, including financial risk protection, access to quality essential health-care services and access to safe, effective, quality and affordable essential medicines and vaccines for all.

PART 5:

Our approach to ESG portfolios

Defining our philosophy, values and beliefs

ESG integration does not dictate or present any values in portfolios, it is often merely a risk management exercise to manage risk/return and tail risks in portfolios. This positively impacts the investment process, and we believe all investment processes should include ESG integration to manage material risks that may affect the end client's performance outcomes. However, clients are often looking for an opportunity to align their own specific values to their portfolios.

Our process begins with defining our values and beliefs, which in turn drives our portfolio thinking and management.

For example, at Binary Capital our "Sustainable Portfolios" are driven by the following values and beliefs:

- Binary Capital has a responsibility to offer all clients genuine institutional investment strategies that meet their needs and preferences, from a risk and return perspective and from a socially responsible/sustainability perspective.
- Integrating ESG and impact investing methodologies can enhance long-term investment returns.
- Binary Capital has a duty to avoid harm on people and the planet with regards to investments managed by avoiding allocating capital to harmful industries and corporates. Not only to avoid harm, but to invest for the positive benefit of people and the planet by aligning investments with the UN SDGs to do good.

Figure 3: Binary Capital Sustainable MPS Fund Selection Process

The Investable Universe: A selection of actively managed funds, managed by our approved fund houses only which match several key characteristics we look for.

↓

Funds that invest in harmful industries and corporates, such as tobacco, palm oil, armaments and gambling are screened out.

↓

Funds are grouped in relation to regional exposure, market cap and investment strategy.

↓

Sustainable Fund Universe(s)

↓

Our in-house quantitative scoring model ranks funds suitability against a range of risk and return measures, investment style and overall investment strategy.

↓

Analyst reports that integrate ESG thinking are presented for our best ideas during our monthly investment committee meetings and evaluated by the panel and CIO.

All funds are subject to an in-depth quantitative and qualitative analysis including meetings with fund managers & investment teams, and a deconstruction of the fund's individual equity holdings. We look at all single equity holdings ensuring alignment with sustainable development. Furthermore, we look to see if funds are aligned with our genuinely active investment framework.

↓

If the Fund is accepted into the buy list by the committee, it can be considered for inclusion into our model portfolios. This is a consensus group decision.

All funds in our model portfolios and the buy list are continually monitored daily. From a risk and return perspective, as well as from the ESG framework.

General step

ESG integrated step

Initial universe of investments

Defining values leads to the generation of criteria that can be used to highlight those funds or investments aligned to such thinking. For example, exclusionary criteria regarding negative externalities, or inclusionary criteria such as thematically focused funds, and investments that benefit people and/or the planet.

There will be a choice whether to use active or passive investment funds or a blend of both. A choice that directs the ESG style of the portfolio. Our preference is an *active, growth style* portfolio management strategy.

Selecting funds from the universe

Funds within our sustainable investment universe are scored within their peer groups against a range of variables related to risk, return, cost and other factors. The top-ranking funds are then taken for a more focused assessment by an investment analyst. Our focus is on funds that can deliver returns over and above their benchmark and importantly offer non-financial returns in alignment with the UN SDGs.

Detailed analysis of funds from a ESG perspective

- Does the fund manager/investment house integrate ESG into all stages of the investment process through research, valuation, portfolio construction, their sell-discipline and post-investment monitoring? Is ESG significantly integrated into the decision-making process - is it core?
- We like fund managers that think long-term and that look to generate consistent and sustainable returns from long-term fundamental and structural factors. Fund managers taking a long-term perspective are more likely to be delivering genuine sustainability-led strategies.
- Is the fund manager directly involved in the engagement process with portfolio companies? Is there genuine intentionality to engage? What is the quality of this engagement?
- Detailed research led assessment of the underlying holdings of funds to see if there are holdings inconsistent with our views, the fund manager's views or not genuinely aligned towards UN SDGs. We map a funds individual holdings to an easily understood proprietary thematic framework highlighting thematic exposure to sustainability themes and if there is any product/service impact. We prefer funds that have clear links to our broad sustainability themes, more so for those with holdings with a clear product/service impact that can be linked to sustainable development.
- Understand the ESG resources afforded to the managers i.e., third party data packages, internal ESG analysts and the overall approach etc.

Portfolio construction

Aligning asset allocation to target strategic asset allocation

At Binary Capital we focus on having a fixed strategic asset allocation. This is a global asset allocation framework. We align all our portfolios to this fixed framework. This is reviewed every year.

Understanding thematic exposure

Understanding thematic exposure to construct a portfolio that takes a balanced approach to people and the planet. Ensure there is a clear, significant exposure to both, minimizing holdings where there is no link. In search of genuine links.

Position conviction levels

Weight fund positions according to conviction levels to maximise long-run performance and generate genuine active portfolios. Be focused. Always invest in our best ideas.

Adjusting for risk

Optimise portfolios to maximise return and ensure maintenance within appropriate risk parameters. Balance the return and risk.

Continued Monitoring

Investments are monitored on a regular basis. Crucially, the ESG focus of the fund and the underlying investments are also monitored. There is a three-way focus on return, risk and ESG metrics. All are considered to determine the allocation of a fund and any changes within. This monitoring is on a weekly, monthly and quarterly basis. However, it is important to note that unless there is a material change, we do not change funds frequently. We are long-term, patient fund holders. We do not believe that changing funds continuously benefits the client in terms of performance outcomes.

Baillie Gifford Positive Change Fund

"Positive Change invests in businesses that can help solve global challenges [...] To find and identify companies powering positive change requires broad horizons – a willingness to look beyond traditional sector classifications, and an open and inclusive, rather than exclusionary, approach – and an inquisitive attitude to possibilities..."

Kate Fox - Positive Change Fund, Joint Fund Manager

Strategy, Values and Philosophy

A fund that looks to deliver positive change in four key areas:

- Social Inclusion and Education,
- Environment and Resource Needs
- Healthcare and Quality of Life
- Addressing the needs of the poorest in the world.

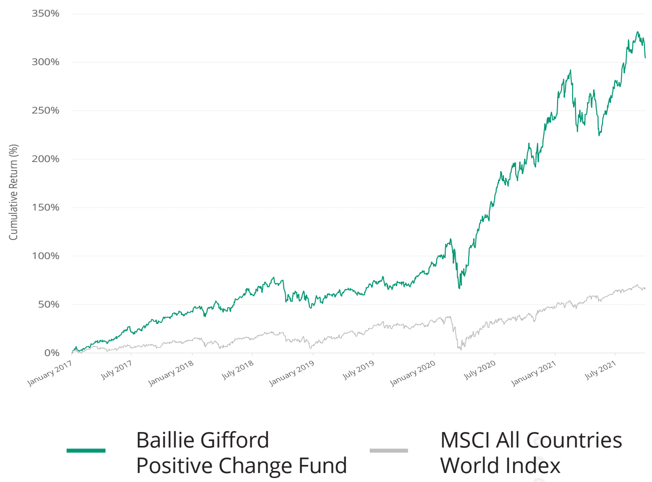
The fund's portfolio mangers experiences and specialisms in climate change, emerging markets and in analysing growth focused, disruptive companies means they are well placed to seek the best global opportunities. They incorporate the above four key areas with the overarching focus of the portfolio founded on Baillie Gifford's long-term style of investing: investing with high conviction, through in-house bottom-up fundamental research, to discover the best "positive change" investments globally and allocate investors capital accordingly.

Through this investment style the Fund managers hope to create a truly differentiated portfolio that can provide an alternative opportunity for more sustainably focused investors.

Key Information	
Inception	January 2017
Style	Global Growth
Exposure	Global equities
OCF	0.53%
Fund Size	£2,862.4m

Key Statistics	Baillie Gifford Positive Change Fund B (Acc)	Benchmark (MSCI ACWI Index)
3 Yr. Annualised Return (%)	30.92	11.10
3 Yr. Annualised Volatility	21.12	25.06
3 Yr. Sharpe Ratio	1.88	0.05

Cumulative Returns (%) of Baillie Gifford Positive Change Fund Vs. MSCI All Countries World Index. Data as at 30.09.2021.



Key ESG Portfolio Characteristics

Investing for positive Impact

The Fund publishes an annual positive change report which uses the 'theory of change' framework. The report demonstrates the impact individual portfolio holdings are providing through their core products or services and publishes these impact statistics delivered by the holdings, and links individual holdings to specific UN SDGs.

Ongoing Stewardship

Fund managers are actively involved in the voting process whilst seeking to positively engage with and influence management teams and companies over the long-term.

The above is not financial advice. Please review full disclaimer. Baillie Gifford Positive Change Fund data sources: Factsheets, Baillie Gifford Positive Change Fund 2021 Impact Report , Bloomberg (Accessed 20.09.2021).

Aegon Asset Management Global Sustainable Equity Fund

Strategy, Values and Philosophy

A high-conviction growth-focused portfolio of 35-45 companies, with a focus on sustainability led innovative and disruptive companies. A focus is on future sustainable leaders. A focus on mid-cap equities.

Sustainability investing has been a core skill-set of the company - with over 30 years experience. The funds strategy is very high conviction with a low portfolio turnover

* The relatively new managers/team will be continually monitored as they replaced the previous team in 2020.

"...only companies designated as sustainability 'leaders' or 'improvers' are considered for inclusion in the portfolio [...] Empirical evidence suggests that identifying and investing in sustainability improvers is one of the most effective ways to generate alpha..."

Aegon, Global Sustainability Fund – Snapshot, June 2021

Key Information	
Inception	April 2016
Style	Growth bias.
Exposure	Global equities
OCF	0.80%
Fund Size	£400m

Key ESG Portfolio Characteristics

Screening process
By a process of screening from 40,000 global equities this leads to around 100 stock ideas of which around 40 are invested.

Thematic thinking
Holdings are linked to seven pillars of sustainability: climate change, eco solutions, resource efficiency, health and wellbeing, inclusion and sustainable growth.

ESG Leaders
They use a proprietary framework for categorizing companies as leaders, improvers and laggards. Excluding laggards from investment.

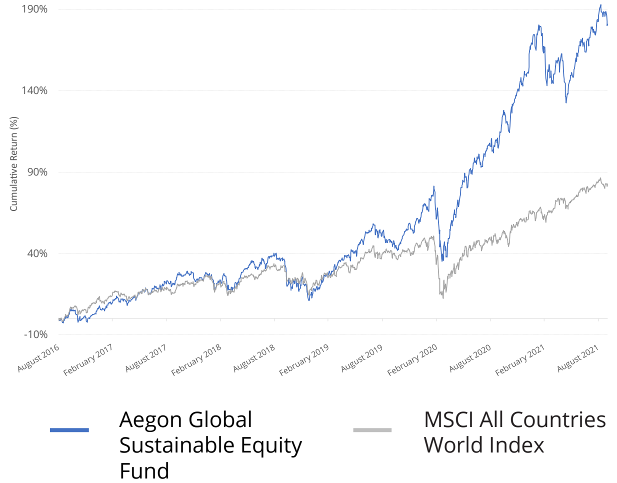
The methodology utilises third party data which is then adjusted based on proprietary assessment of the company's practices. The analysts also consider products and services impact on society throughout the supply chain.

Exclusionary approach
Tobacco, weaponry, nuclear power, gambling and adult entertainment, fossil fuels, human rights violations. Standard exclusions undertaken.

Robust reporting
The fund publishes a detailed annual sustainability report which covers the underlying holdings and links to sustainability themes clearly.

Key Statistics	Aegon Global Sustainable Equity Fund B (Acc)	Benchmark (MSCI ACWI Index)
3 Yr. Annualised Return (%)	25.90	11.10
3 Yr. Annualised Volatility	21.71	25.06
3 Yr. Sharpe Ratio	1.83	0.05

Cumulative Returns (%) of Aegon Global Sustainable Equity Fund Vs. MSCI All Countries World Index. Data as at 30.09.2021.



The above is not financial advice. Please review full disclaimer. Aegon Global Sustainable Equity Fund data sources: Factsheets, Aegon Global Sustainable Fund 2021 Impact Report, Bloomberg (Accessed 20.09.2021).

Liontrust Sustainable Future Corporate Bond Fund

" The team looks at the world through the prism of three mega trends [...] and 21 themes within these...with a focus on high-quality issues to reduce bond specific risk."

Liontrust, Sustainability and Impact Report

Strategy, Values and Philosophy

A fixed income strategy which is managed through the Liontrust sustainable future investment process. Alongside typical fixed income metrics, ESG is used as a tool to source quality investments. The majority of the investments are UK based bonds.

Key ESG Portfolio Characteristics

Thinking thematically

Three core themes:

- Greater Safety and Resilience
- Better resource efficiency
- Improved health.

A focus on quality bond issues and income yield - current yield of 2.5%. An 80% minimum requirement of bonds rated BBB or higher must be held in the portfolio.

A dominant theme is that the financial services such as banking and insurance are important - linking such assets to the "greater safety and resilience" theme. This contributes to the portfolio's alignment to the SDG 8: Decent work and economic growth (currently 37%) with banks accounting for around 20% of the portfolio.

Sustainability thinking runs through the whole Liontrust investment process, from equities to bonds, and an in-house proprietary model is used for the sustainable analysis.

Positive trends in sustainability

The fund holds investments that have a greater percentage of their revenues in positive sustainable investment themes.

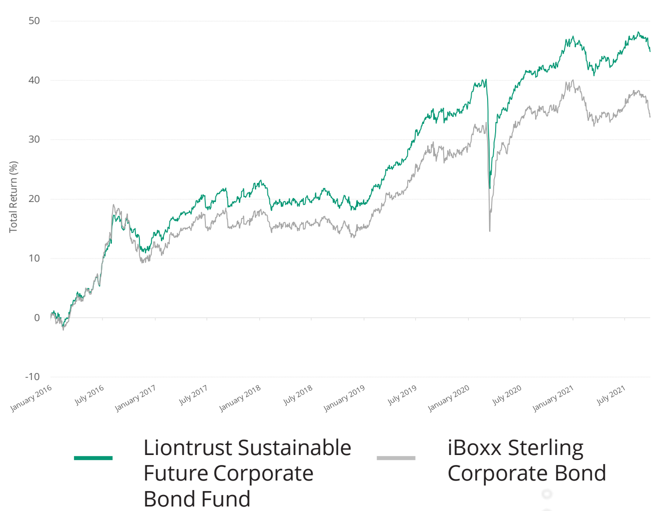
Investments are also less climate polluters than the equivalent index. The fund has around 10% invested in companies providing technologies and zero allocations to thermal coal and oil.

Only one investment is held with exposure to fossil fuels – SSE Plc. This is a de minimis and reducing allocation. SSE has a significant focus on renewable energy and continues to sell down parts of the business exposed to fossil fuels.

Key Information	
Inception	January 2013
Style	Income and Capital Growth
Exposure	Sterling Corporate Bonds
OCF	0.59%
Fund Size	£860.5m

Key Statistics	Liontrust Sustainable Future Corporate Bond Fund	Benchmark (iBoxx Sterling Corporates Bond TR Index)
3 Yr. Annualised Return (%)	9.0	7.2
3 Yr. Annualised Volatility	5.44	6.26
3 Yr. Sharpe Ratio	1.09	0.74

Cumulative Returns (%) of Liontrust Sustainable Future Corporate Bond Fund Vs. iBoxx Sterling Corporate Bond. Data as at 31.09.2021.



The above is not financial advice. Please review full disclaimer. Liontrust Sustainable Future Corporate Bond data sources: Factsheets, Liontrust Sustainability and Impact Report, Bloomberg (Accessed 20.09.2021).

Greenwashing

Greenwashing is essentially marketing products that are perceived to be ethical/ESG and/or sustainable, but in reality are not. It is a serious and real problem in the investment management industry. It is a growing trend.

The investment industry is typically seen as a marketing and sales machine, with many products seen from a marketing, PR lens. The industry spends millions on marketing in multiple formats, with digital marketing becoming increasingly relevant. With such marketing, PR and targeted campaigning around products being used to drive AUM, the product narrative in marketing language can create difficulties separating the truth from the misleading terminology or investment spin. It is an ongoing challenge.

As the interest of such products has boomed in recent years, investment and regulatory agencies have look closely at the issue of greenwashing. The introduction of new Sustainable Finance Disclosure Regulation (SFDR) in the EU has prompted asset managers to address how they market funds and categorise funds based on their quality of sustainability engagement (SFDR 6, 8 or 9).

At Binary Capital we take the issue of greenwashing very seriously. It is a real issue and indeed a threat to many good ESG products and genuine sustainable investment strategies. That is why we do not assume a product is what it says it is. We look deeper and examine closely.

We take our time understanding the product. We look carefully at the underlying holdings to really understand the key determinants within an individual company, finding out the whole ESG and sustainable impact of an investment portfolio. Doing this at a very detailed level. We undertake fundamental portfolio and fund analysis to determine in our view whether a strategy does fulfil the ESG/ethical metrics determined. This is undertaken in addition to all of the usual metrics to conclude whether there is value in holding an investment in line with our overall investment strategy.

It is important to be aware that there are thousands of ESG products in the marketplace with only a select minority are genuinely achieving what they claim. We hope to see a more unified approach across the investment industry in the years to come. We will always continue to perform our own independent analysis and demonstrate continued thought leadership.

Closing Remarks

The focus of this paper was to provide a greater insight into the practicalities of integrating ESG, sustainability and impact investing across the spectrum of available investment products. We hope that we have been able to convey some of the most prevalent features in this ever-growing segment of the investment industry.

An understanding of how ESG metrics fits into the construction of genuine sustainable portfolios is crucial to provide a transparent solution for clients that truly meets their investment objectives.

With our substantial interest in this area, we hope to have demonstrated our expertise and research capabilities to deliver high performing sustainable solutions. We at Binary Capital, treat our sustainable MPS as a core offering in our investment solutions framework. It is central to our work. Indeed sustainable investment philosophies drive our overall investment thinking.

Sustainable investments are disrupting the status quo. We are playing a part on this journey to better sustainable and investment outcomes.

Disclaimer

The Information in this document is not intended to influence you in making any investment decisions and should not be considered as advice or a recommendation to invest. Any Information may not be suitable for all investors and investors must make their own investment decisions using their own independent advisors and relevant offering material. Any investment decisions must be based upon an investor's specific financial situation and investment objectives and should be based solely on the information in the relevant offering memorandum. Income from an investment may fluctuate and the price or value of any financial instruments referenced in this document may rise or fall. Past performance is not necessarily indicative of future results.

We assume no responsibility or liability for the correctness, accuracy, timeliness or completeness of the Information. We do not accept any responsibility to update the Information. Any views, opinions or assumptions may be subject to change without notice.

Binary Capital Investment Management Ltd is incorporated in England under company number 06692644, registered office, 15 Half Moon Street, London, W1J 7DZ. Binary Capital is a trading name of Binary Capital Investment Management Ltd.

Binary Capital Investment Management Ltd is authorised and regulated by the UK Financial Conduct Authority (reference number 507900). Principal place of business: 15 Half Moon Street, London, W1J 7DZ.

Contact Us

+44 (0)203 943 5080 info@binarycapital.co.uk 15 Half Moon St, Mayfair, London, W1J 7DZ