Greenwashing

Misclassification and Mis-selling of Ethical Investments

November 2019

Time for the Regulator to step in



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for smart investors

Executive summary

2019 is proving to be the year in which ethical investing is coming of age as investors increasingly seeking to prioritise Environmental, Social and Governance considerations, as well as outperformance; especially amongst socially conscious millennial investors.

To satisfy this investor requirement, we are witnessing a plethora of ESG (Environmental, Social and Governance), SRI (Socially Responsible Investing) and other ethically based strategies being launched; in the UK and internationally.

In the rush to satisfy this growing consumer demand, companies are launching products amidst a data fog where it is difficult to see or identify what is really being held within these funds. Whether it is deliberate or accidental, clients who wish to satisfy their twin goals of return terms as well as having regard for the planet and society, are being taken advantage of in numerous ways.

There is no denying that there is a real opportunity for investors to be prudent as well as using their money for positive change, but the ethical investment sector must be responsible and take every care to ensure their investment products are as genuine, measurable and transparent as possible. Of course, there is no perfect way to invest ethically or otherwise and naturally there will always be drawbacks to any investment or investment strategy, but clients should be able to decide fairly based on considered analysis, rather than emotive and misleading marketing.

Unfortunately, new research within this report by SCM Direct indicates widespread misclassification and mis-selling. **Based on this research, it is the view of SCM Direct that the UK regulator should conduct an urgent industry review, rather than its normal strategy of stepping in after investors have already been exploited.**

In view of the vast array of products and the difficulties in agreeing global benchmarks and best practice, SCM Direct suggests looking through the other end of the telescope as what is deemed ethical by one investor may well differ from the criteria of another investor. Rather than shoehorning products into particular product categories, investors should be given a fully transparent list of holdings, all costs and all details on ethical investment strategies so they can make fully informed decisions about where a particular product fits their individual investment parameters, rather than potentially being misled.

SCM Direct research findings

1. No rules or regulations on the calculation of ethical data.

2. Some funds appeared to be mis-classified as having an *"ethical"* investment focus.

3. Various ethical funds were found to be investing material amounts in tobacco, alcohol, gambling and defence stocks.

4. Key ethical quantitative data provided by companies are not audited and open to widespread abuse.

5. Ethical scores/ratings vary enormously between data providers in terms of individual securities. For example, Tesla is top on one provider's scoring, bottom by another and average by another. When a company fails to disclose a piece of information to a provider, one data provider gave it a low score whilst another assumes an average score for the missing item.

6. Ethical scores/ratings vary enormously between data providers in terms of individual funds. For example, an identical search for *"socially responsible"* funds utilising two different investment platforms (powered by the same data provider) produced completely contradictory results.

7. Many ethical funds/strategies found to be investing significant amounts via plain vanilla Government Bonds e.g. one ethical portfolio invested 96% of its assets in a UK Government Bond fund, just 3% via an ethical fund and 1% in cash.

8. The average Ethical Equity mutual fund underperformed the market by 2.5% per annum over the three years to end June 2019, compared to a 0.8% per annum underperformance for the average passive ethical equities fund.

SCM Direct recommendations

1. Common data accounting standards for this product sector should be internationally agreed to include standardised data points so key data can be independently audited and signed off.

2. Industry wide collaboration so large data providers are encouraged to work with each other to discuss and resolve *"discrepancies"* in approach and results.

3. The FCA urgently starts a review of the UK ethical investment sector and considers enforcement against funds/portfolios whose marketing materials are found to be misleading clients.

4. Given the wide range of strategies and philosophies, and opposing views on individual securities, investors should be afforded 100% transparency, on a regular six-monthly basis, so they are fully aware of the full list of securities held in their investments. This would enable them to make fully informed decisions that best match their own ethical parameters.

5. Funds/portfolios should not be allowed to be marketed as *"ethical"* portfolios unless all the assets (excluding cash) are via *"ethical"* investments - rather than plain vanilla Government Bond funds or other non *"ethical"* funds.

1. Background - What is an ethical fund?

Ethical investing refers to an investor approach based on an individual's ethical principles and beliefs as the primary filter for investment selection. The producers of ethical funds market to this target market under the grouping of Socially Responsible Investing (SRI) or Environmental, Social and Governance (ESG) investing. Other common strategies include social investment, also known as sustainable, socially conscious, *"green"* or *"sustainable investing"* or *"responsible investing"*. There is also a subset of SRI known as *"impact investing"*, devoted to the conscious creation of social impact through investment.

In general, socially responsible investors prioritise and support corporate practices that they believe promote principles and practices such as environmental stewardship, consumer protection, human rights, and racial or gender diversity. Some SRIs avoid businesses in sectors perceived to have negative social effects, commonly alcohol, tobacco, fast food, gambling, pornography, weapons, contraception/abortifacients/abortion, fossil fuel production or the military. The areas of concern recognised by the SRI practitioners are sometimes summarised under the heading of ESG issues: Environment, Social, and corporate Governance, or responsible investing.

Despite significant growth in this area, regulators have been slow to provide a definition or methodology of what constitutes responsible investing; leaving it to investment managers and data providers to self-identify and define. We believe this has led to an alarming level of what is being identified as *"Greenwashing"* - a practice of making misleading claims about the environmental benefits of a fund / investment or company.

Some international institutions are alert to the issue, such as the European Union who passed a **Directive on Disclosure of Non-financial and Diversity Information**[1] that mandates large publicly held entities to issue sustainability information.

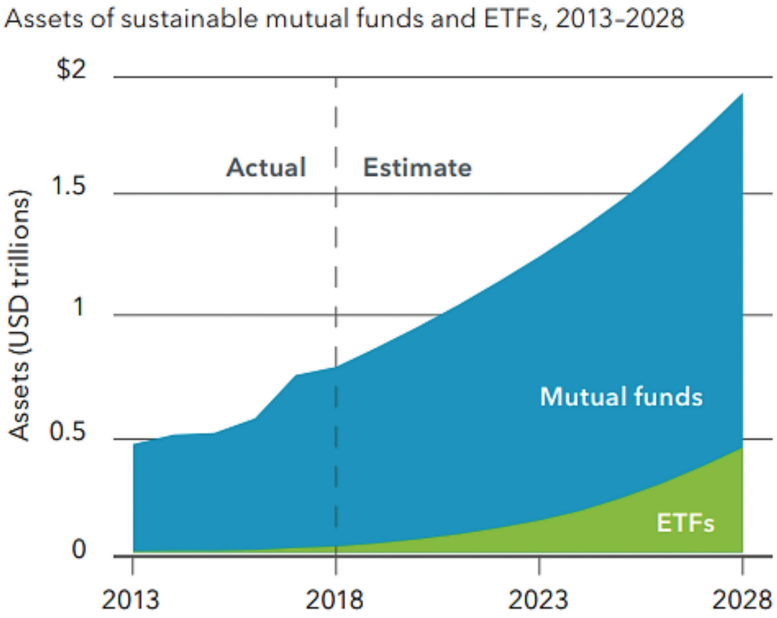
Initiatives such as United Nations Principles for Responsible Investment, UN Global Compact and the Global Reporting Initiative have emerged to make clear what constitutes responsible investment and to promote it through the support of extra-financial reporting. **However consistent, commonly agreed criteria and benchmarking marking remains an uphill struggle.**

[1] https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/non-financial-reporting_en

2. Growth in ethical funds

According to the UK's Investment Association, 26% of total assets under management within the UK are being managed with a responsible investment approach[2].

The universe of dedicated sustainable investment funds in European and U.S. mutual funds and Exchange Traded Funds (ETFs) has grown from $453 billion in 2013 to c.$760 billion recently. This increase is predicted to rise exponentially[3].



There's no guarantee that forward-looking estimates will come to pass.

Sources: BlackRock, with data from Broadridge/Simfund, June 2018.

Notes: The chart shows the total assets under management in ESG mutual funds (MFs) and ETFs globally. The 2019 to 2028 figures are based on BlackRock estimates, assuming a 5% annual growth rate in the underlying markets.

Other assumptions: MF asset growth starts at 5% in 2019 and declines by 0.5% annually throughout 2022, then at a zero-to-0.5% rate annually thereafter. ETF asset growth starts at 45% and decreases by 5% annually throughout 2022, with a zero-to-3% pace thereafter.

[2] https://www-investmentassociation.m-w.site/sites/default/files/2019-09/IMS%20full%20report%202019.pdf

[3] https://www.blackrock.com/ch/individual/en/literature/whitepaper/bii-sustainability-future-investing-jan-2019.pdf

3. Misclassification of funds by data providers/investment platforms

Fidelity appears to misclassify many funds as being *"socially responsible funds"*.

When SCM searched the Fidelity platform for all funds managed by Fidelity that were deemed "socially responsible funds" [4], the following 49 share classes appeared but SCM found only two (both of which related to the same underlying fund) that suggested such an investment focus within the KIID.

It is interesting to note that the FCA itself [5] has stated that:

"Our Policy Statement (PS19/4), issued in February 2019, included non-handbook guidance clarifying that a fund should set out clearly in its Key Information Document if it pursues environmental, social or other non-financial objectives, and how it does so."

Furthermore, Fidelity only manages two funds which it describes as being *"specifically tailored for ESG":* the FT Sustainable Water and Waste Fund (this appears within the list of 49 funds) and the Fidelity FIRST ESG All Country World Fund [6].

It should also be noted that Fidelity states that it has integrated ESG into their overall investment process[7] - *"ESG analysis is carried out at analyst level within the equity, fixed income, real estate and multi-asset teams and our portfolio managers are also active in analysing the potential effects of these factors when making investment decisions."* However, Fidelity also states that this leads to just 17 stocks worldwide being specifically excluded (cluster munitions and anti-personnel landmine companies).

For example, within the table on the following pages is the Fidelity European Dynamic Growth Fund[8] which holds 6.2% in tobacco companies (3.3% BATS, 1.7% Imperial Brands and 1.2% Swedish Match) as at 30th April 2019.

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[4] https://www.fidelity.co.uk/planning-guidance/investment-finder/#?investmentType=funds&filtersSelectedValue=%7B%22ethicalFunds%22:%22true%22,%22fidelityFundsOnly%22:%22BN000008QX%22%7D&page=1&perPage=50&sortField=legalName&sortOrder=asc&subUniverseId=MFEI&universeId=FOGBR$$ALL_3521

[5] https://www.fca.org.uk/publication/feedback/fs19-6.pdf

[6] https://www.fidelity.co.uk/responsible-investing/

[7] https://www.fidelity.co.uk/responsible-investing/

[8] https://www.fundslibrary.co.uk/FundsLibrary.DataRetrieval/Documents.aspx/?type=packet_fund_doc_reports_and_accounts&id=f9946b69-21c9-4e8f-9eea-3745a2479dd6&user=H%2fVZBtjpaEbpUyAtjDwYIeM%2flWQbJ7L3gZ6Ndzc6Z2W-BLB6NcT3QK8MjqCP4BZTP&r=1

Add to shortlist	Name ▲	Negotiated discount(%) ▼	Yield(%) ▼	On-going charge(%) ▼	Asset class ▼	Morningstar rating ▼	
☐	Fidelity Active Strategy - FAST - Asia Fund Y-ACC-GBP	–	0.00	1.32	–	★★★★	Deal
☐	Fidelity Active Strategy - FAST - Emerging Markets Fund Y-ACC-GBP	–	0.00	1.29	–	★★★★	Deal
☐	Fidelity Active Strategy - FAST - Europe Fund W-ACC-GBP	–	0.00	1.28	–	★★★★★	Deal
☐	Fidelity Active Strategy - FAST - Global Fund Y-ACC-GBP	–	0.00	1.33	–	★★★	Deal
☐	Fidelity Active Strategy - FAST - UK Fund Y-ACC-GBP	–	0.00	1.30	UK	★★★★★	Deal
☐	Fidelity Active Strategy - FAST - US Fund Y-ACC-GBP	–	0.00	1.29	–	★★★★	Deal
☐	Fidelity Funds - America Fund W-Acc-GBP	–	0.00	1.03	–	★★★	Deal
☐	Fidelity Funds - American Growth Fund W-Acc-GBP	–	0.00	1.05	–	★★★	Deal
☐	Fidelity Funds - American Growth Fund W-Acc-GBP-Hdg	–	–	1.05	–	–	Deal
☐	Fidelity Funds - Asia Focus Fund W-Acc-GBP	–	0.00	1.08	Asia and Emerging Markets	★★★★	Deal
☐	Fidelity Funds - Asian High Yield Fund W-Acc-GBP	–	0.00	0.89	–	★★★★★	Deal
☐	Fidelity Funds - Asian Smaller Companies Fund Y-Acc-GBP	–	0.00	1.10	Asia and Emerging Markets	★★★★★	Deal
☐	SELECT 50 DISCOUNT Fidelity Funds - Asian Special Situations Fund W-DIST-GBP	0.10	0.89	1.08	Asia and Emerging Markets	★★★★	Deal
☐	Fidelity Funds - China Focus Fund Y-DIST-GBP	–	2.02	1.06	Asia and Emerging Markets	★★★★★	Deal
☐	Fidelity Funds - Emerging Asia Fund W-Acc-GBP	–	0.00	1.09	Asia and Emerging Markets	★★★★★	Deal
☐	Fidelity Funds - Emerging Market Debt Fund W-Acc-GBP	–	0.00	0.90	Bonds	★★★★	Deal
☐	Fidelity Funds - Emerging Markets Focus Fund W-Inc-GBP	–	–	1.10	–	–	Deal
☐	Fidelity Funds - Emerging Markets Fund W-Acc-GBP	–	0.00	1.08	–	★★★★★	Deal
☐	Fidelity Funds - Emerging Markets Fund W-DIST-GBP	–	0.93	1.08	–	–	Deal
☐	Fidelity Funds - Emerging Markets Inflation-linked Bond Fund Y-DIST-GBP	–	2.54	0.94	–	–	Deal
☐	Fidelity Funds - Euro Blue Chip Fund W-Acc-GBP	–	0.00	1.07	–	★★★★	Deal
☐	Fidelity Funds - European Dividend Fund W-Inc-GBP	–	–	1.09	–	–	Deal
☐	Fidelity Funds - European Dynamic Growth Fund W-Acc-GBP	–	0.00	1.05	Europe	★★★★★	Deal
☐	SELECT 50 DISCOUNT Fidelity Funds - European Growth Fund W-Acc-GBP	0.10	0.00	1.04	Europe	★★★	Deal
☐	Fidelity Funds - European High Yield Fund Y-Acc-GBP (hedged)	–	0.00	0.89	–	–	Deal
☐	Fidelity Funds - Flexible Bond Fund Y-DIST-GBP	–	2.63	0.78	–	★★★	Deal
☐	Fidelity Funds - Global Communications Fund W Acc GBP	–	–	1.10	–	–	Deal

continued...

Fidelity Funds - Global Consumer Industries Fund W-Acc-GBP	–	0.00	1.06	Global	★★★★		Deal
Fidelity Funds - Global Demographics Fund Y-Acc-GBP	–	0.00	1.09	–	★★★★		Deal
Fidelity Funds - Global Dividend Fund W-Acc-GBP	–	0.00	1.04	–	★★★★★		Deal
Fidelity Funds - Global Dividend Fund W-QINCOME(G)-GBP	–	2.55	1.04	–	★★★★★		Deal
Fidelity Funds - Global Dividend Fund W-QINCOME(G)-GBP (hedged)	–	2.56	1.04	–	–		Deal
Fidelity Funds - Global Financial Services Fund W-Acc-GBP	–	0.00	1.06	Global	★★★★		Deal
Fidelity Funds - Global Focus Fund W-Acc-GBP	–	0.00	1.08	–	★★★★		Deal
Fidelity Funds - Global Health Care Fund W-Acc-GBP	–	0.00	1.06	Global	★★★★		Deal
Fidelity Funds - Global Industrials Fund W-Acc-GBP	–	0.00	1.10	Global	★★★		Deal
Fidelity Funds - Global Low Volatility Equity Fund W GBP Inc	–	–	0.93	–	–		Deal
Fidelity Funds - Global Property Fund W-Acc-GBP	–	0.00	1.09	–	★★★★		Deal
Fidelity Funds - Global Technology Fund W-Acc-GBP	–	0.00	1.04	Alternatives and Other	★★★★★		Deal
Fidelity Funds - India Focus Fund Y-GBP	–	0.00	1.09	Alternatives and Other	★★★★		Deal
Fidelity Funds - International Fund W-Acc-GBP	–	0.00	1.05	–	★★★★		Deal
Fidelity Funds - Latin America Fund W-Acc-GBP	–	0.00	1.08	Alternatives and Other	★★★★		Deal
Fidelity Funds - Pacific Fund W-Acc-GBP	–	0.00	1.08	–	★★★★		Deal
Fidelity Funds - Sterling Cash Fund W-Acc-GBP	–	0.00	0.41	–	–		Deal
Fidelity Funds - Sustainable Water & Waste Fund W Acc GBP	–	–	1.10	Global	–		Deal
Fidelity Funds - Sustainable Water & Waste Fund W Inc GBP	–	–	1.10	Global	–		Deal
Fidelity Funds - United Kingdom Fund Y-Acc-GBP	–	0.00	1.09	–	★★		Deal

Important Note

This report and links found within the report were updated during October 2019. It should be noted that as a result of being contacted by The Sunday Times in connection with an article detailing this report, Fidelity has amended its platform website to remove the ability to search for "socially responsible" funds.

SCM Direct believes that whilst such action is welcomed, it should not be necessary for SCM to continually have to highlight poor practice in the industry. If we had a regulator that was fit for purpose in protecting consumers interests, research reports such as this Greenwashing Report would not be required.

Fidelity Funds on the Willis Owen

SCM conducted the same search as they did on Fidelity's own platform, searching for Fidelity managed *"socially responsible funds"*[9] available on the Willis Owen platform (as at October 2019) – both platforms are powered by Morningstar, but just five funds appeared on the Willis Owen platform compared to 49 on Fidelity's platform, none of which had a KIID document referring to an ethical related strategy:

Name	Last Close Price	Yield(%)	Ongoing Charge(%)	IA Sector	Morningstar Analyst Rating™	Morningstar Rating™	Morningstar Sustainability Rating™
Fidelity Funds - China Focus Fund Y-DIST-GBP	2.02 GBP	2.02	1.06	China/Greater China	Silver	★★★★★	
Fidelity Funds - Global Dividend Fund W-QINCOME(G)-GBP (hedged)	1.23 GBP	2.56	1.04	–	–	–	
Fidelity Funds - Global Health Care Fund W-Acc-GBP TRE	2.00 GBP	0.00	1.07	Global	–	★★★★	
Fidelity Funds - Global Technology Fund W-Acc-GBP TRE	3.37 GBP	0.00	1.04	Technology and Telecommunications	–	★★★★★	
Fidelity Funds - India Focus Fund Y-GBP	2.59 GBP	0.00	1.09	Specialist	Bronze	★★★★	

Many of the Fidelity funds e.g. the Fidelity European Opportunities Fund were not classified as *"socially responsible funds"* on the Willis Owen screening mechanism, but were classified as *"socially responsible funds"* on the Fidelity screening mechanism (both investments platforms are powered by Morningstar).

IWeb[10]

A search for funds according to their *"Morningstar sustainability rating type"* found several funds which were classified as having a low sustainability rating, even though the fund name and attributes would suggest the opposite. For example, the Kames Global Sustainable Equity fund[11] is managed with pre-defined sustainability criteria[12] e.g. not investing in companies involved in adult entertainment, animal testing, gambling, genetic modification, tobacco, weapons and nuclear power and furthermore applying *"multiple data sources including data from ESG (environment, social & governance) rating agencies, broker research and primary research"* but this received a low Morningstar sustainability rating of 1[13] (the maximum being 5) as at October 2019.

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[9] https://www.willisowen.co.uk/explore/explore-funds#?filtersSelectedValue=%7B%22brandingCompany-Id%22:%7B%22id%22:%22BN000008QX%22%7D,%22ethicalFunds%22:%7B%22id%22:%22true%22%7D%7D&page=1&perPage=10&sortField=legalName&sortOrder=asc&universeId=FOGBR$$ALL_4586

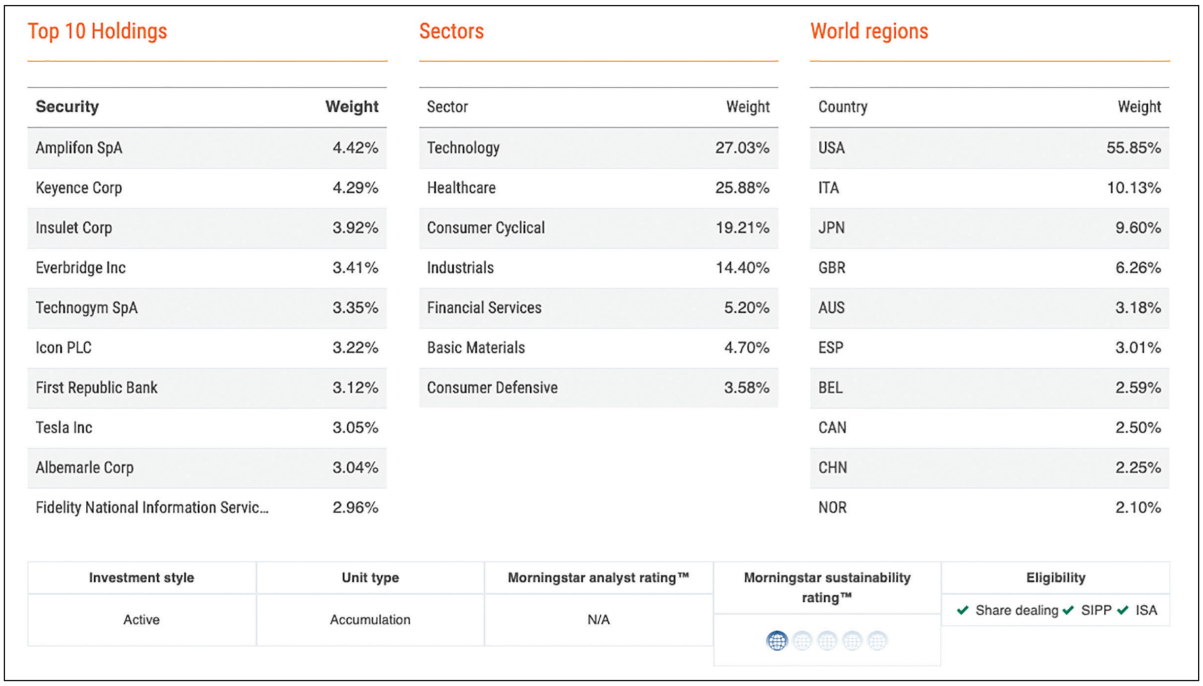
[10] https://www.markets.iweb-sharedealing.co.uk/funds-centre/fund-supermarket/

[11] https://www.markets.iweb-sharedealing.co.uk/funds-centre/fund-supermarket/detail/IE00BYZJ3441

[12] https://www.aegonassetmanagement.com/globalassets/asset-management/netherlands/strategies/documents/ucits/kames-funds/gsef/prospectus-kames-global-sustainable-equity-fund.pdf

[13] https://www.markets.iweb-sharedealing.co.uk/funds-centre/fund-supermarket/detail/IE00BYZJ3441

Kames Global Sustainable Equity fund [14]



Top 10 Holdings

Security	Weight
Amplifon SpA	4.42%
Keyence Corp	4.29%
Insulet Corp	3.92%
Everbridge Inc	3.41%
Technogym SpA	3.35%
Icon PLC	3.22%
First Republic Bank	3.12%
Tesla Inc	3.05%
Albemarle Corp	3.04%
Fidelity National Information Servic...	2.96%

Sectors

Sector	Weight
Technology	27.03%
Healthcare	25.88%
Consumer Cyclical	19.21%
Industrials	14.40%
Financial Services	5.20%
Basic Materials	4.70%
Consumer Defensive	3.58%

World regions

Country	Weight
USA	55.85%
ITA	10.13%
JPN	9.60%
GBR	6.26%
AUS	3.18%
ESP	3.01%
BEL	2.59%
CAN	2.50%
CHN	2.25%
NOR	2.10%

Investment style	Unit type	Morningstar analyst rating™	Morningstar sustainability rating™	Eligibility
Active	Accumulation	N/A		✔ Share dealing ✔ SIPP ✔ ISA

Similarly, the SVM All Europe SRI fund received the same low Morningstar sustainability score [15] (as at October 2019) even though the fund *"adopts a positive engagement approach toward investment and enters into meaningful dialogue with companies regarding social and environmental issues."* [16]



Top 10 Holdings

Security	Weight
Prudential PLC	6.99%
Norcros PLC	6.08%
DCC PLC	5.08%
AXA SA	4.64%
Smurfit Kappa Group PLC	4.33%
Synthomer PLC	4.06%
Danone SA	3.85%
Forterra PLC	3.72%
Capgemini SE	3.64%
Informa PLC	3.43%

Sectors

Sector	Weight
Financial Services	24.72%
Industrials	19.53%
Basic Materials	16.99%
Consumer Cyclical	10.49%
Technology	7.53%
Consumer Defensive	7.15%
Energy	5.09%
Healthcare	4.75%
Communication Services	3.44%
Utilities	0.31%

World regions

Country	Weight
GBR	64.68%
FRA	17.17%
DEU	9.80%
NLD	3.29%
CHE	2.57%
IRL	2.49%

Investment style	Unit type	Morningstar analyst rating™	Morningstar sustainability rating™	Eligibility
Active	Accumulation	N/A		✔ Share dealing ✔ SIPP ✔ ISA

[14] https://www.markets.iweb-sharedealing.co.uk/funds-centre/fund-supermarket/detail/IE00BYZJ3441

[15] https://www.markets.iweb-sharedealing.co.uk/funds-centre/fund-supermarket/detail/GB00B1FL7V46

[16] https://www.fundslibrary.co.uk/FundsLibrary.DataRetrieval/Documents.aspx/?type=packet_fund_class_doc_factsheet_private&id=51484fa4-dabe-4475-9be0-48317bbfb32c&user=Z4ZHs%2bjzLBcHQva4YDrMJ36mxxVcPZpwzTLqNT9fpdrls-DjMaQw7IMixey%2fwGRyD&r=1

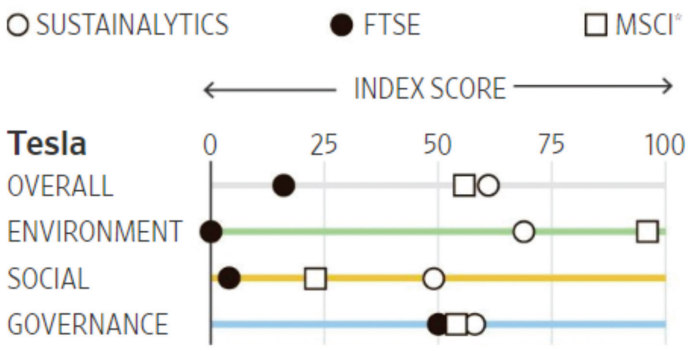
4. Ethical scores and ratings vary enormously between data providers

There is very low correlation between ESG scores for companies according to two leading data providers – FTSE and MSCI.

A big brand example of the variance is Tesla[17] which is ranked by MSCI at the top of the industry, and by FTSE as the worst carmaker globally on ESG issues. Whilst Sustainalytics put them in the middle.

MSCI gave Tesla a near-perfect score for environment, due to its emphasis on the low carbon produced and its clean technology whilst FTSE gave it a *"zero"* on environment as it only rates the emissions from its factories.

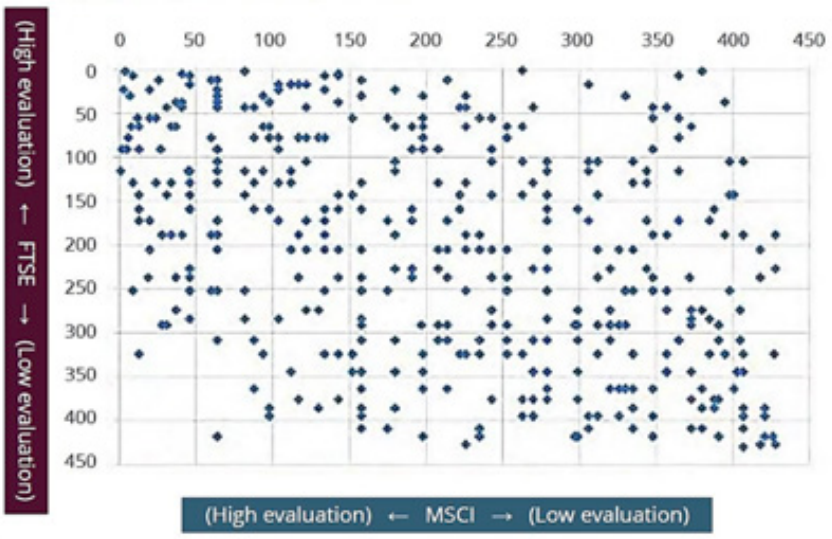
FTSE also assumes a company not disclosing a piece of information receives a low score for the missing item whilst MSCI assumes an average score.



Source: The Wall Street Journal

Investment group, CLSA, analysed 400 ratings from FTSE and MSCI and plotted each company and their evaluation score. You would expect them to be similar, as both index providers ranking companies similarly.

[17] https://www.wsj.com/articles/is-tesla-or-exxon-more-sustainable-it-depends-whom-you-ask-1537199931



Source: CLSA, GPIF

The SCM team decided to look at other well-known companies that investors might expect to have a poor ESG rating to see how they fared.

For example:

- Boeing (major defence and aerospace operations)
- BAE Systems (major defence contractor)
- BAT (major tobacco company)
- Exxon Mobil (major oil and gas company).

All these companies received an average ESG rating according to Sustainalytics – where a score of 1 is the worst and 100 is the best.

Boeing[18]

Environment, Social and Governance (ESG) Ratings

Total ESG score	Environment	Social	Governance
52 24th percentile	**54** 39th percentile	**43** 10th percentile	**61** 39th percentile
Average Performer			

BAE Systems[19]

Environment, Social and Governance (ESG) Ratings

Total ESG score	Environment	Social	Governance
62 54th percentile	**58** 46th percentile	**59** 54th percentile	**70** 79th percentil
Average Performer			

[18] https://finance.yahoo.com/quote/BA/sustainability?p=BA&.tsrc=fin-srch

[19] https://finance.yahoo.com/quote/BA.L/sustainability?p=BA.L&.tsrc=fin-srch

British American Tobacco[20]

Environment, Social and Governance (ESG) Ratings

Total ESG score	Environment	Social	Governance
65 77th percentile	**76** 93rd percentile	**60** 70th percentile	**57** 36th percentile
Average Performer			

EXXON Mobil[21]

Environment, Social and Governance (ESG) Ratings

Total ESG score	Environment	Social	Governance
64 63rd percentile	**55** 46th percentile	**75** 79th percentile	**58** 24th percentile
Average Performer			

(As at october 2019)

It could be argued that with more than 125 ESG data providers in the market since 2016 with no agreed common criteria or benchmarks, according to the Global Initiative for Sustainability Ratings, it is hardly surprising that there is no consensus.

State Street recently found that typically only half of companies analysed had a consistent score between four well known providers[22] and that *"Most data providers treat their methodologies as proprietary information. By relying on an ESG data provider's score, asset owners are taking on the perspectives of that provider without a full understanding of how the provider arrived at those conclusions."*

ESG Scores are Different Across Providers
(Cross Sectional Correlation for Constituents of the MSCI World Index, June 30, 2017)

	Sustainalytics	MSCI	RobecoSAM	Bloomberg ESG
Sustainalytics	1	0.53	0.76	0.66
MSCI		1	0.48	0.47
RobecoSAM			1	0.68
Bloomberg ESG				1

4.1 No rules or regulations on how ESG data is calculated

According to Bloomberg,[23] *"The ESG ratings industry is…much less regulated than the world of credit ratings, with no official standards and qualifications."*

There are no laws or regulations, only guidance from national regulators which has led to different interpretations and standards in different countries.

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[20] https://finance.yahoo.com/quote/BATS.L/sustainability?p=BATS.L&.tsrc=fin-srch

[21] https://finance.yahoo.com/quote/XOM/sustainability?p=XOM&.tsrc=fin-srch

[22] https://www.ssga.com/investment-topics/environmental-social-governance/2019/03/esg-data-challenge.pdf

[23] https://www.bloomberg.com/news/articles/2019-08-11/how-to-tell-if-your-investment-is-really-responsible-quicktake

This has allowed 'greenwashing' to flourish, where funds make an unsubstantiated or misleading claim about the environmental benefits of a product, service, technology or company practice.

Even the FCA has spotted this[24]:

"There are currently no universally agreed common, minimum standards and guiding principles for measuring the performance and impact of green finance products." ...

"Issuers do not have a consistent approach to disclosing climate-related risks and it is not clear whether the currently available data are helping investors make informed assessments, or if they may be causing confusion or even distorting markets."

Recently, the FCA[25] stated that:

"We have carried out some initial diagnostic work on firms' sustainable product offerings, to gauge whether there is evidence of potential greenwashing. Early indications from this work are that the 'sustainable' label is applied to a very wide range of products. ***On the face of it, some of these do not appear to have materially different exposures to products that do not have such a label."*** *...."We will challenge firms where we see potential greenwashing and take appropriate action to prevent consumers being misled."*

In April 2019[26] the head of the International Accounting Standards Body (IASB), which sets the accounting rules followed by 144 countries, admitted that greater reporting on companies' sustainability is unlikely to make them behave better and that *"Greenwashing is rampant."*

He also stated that the IASB had no plans to create its own sustainability reporting standards: *"Setting sustainability reporting standards requires expertise that we simply do not have"*.

This begs the question, who is going to do this work or has the expertise?

4.2 Many ethical funds and strategies found to be investing significant amounts via plain vanilla Government Bonds

Government Bonds are being included in ethical funds or portfolios, and are effectively being classed as *"green"* by many managers, even though the various governments would

[24] https://www.fca.org.uk/publication/discussion/dp18-08.pdf

[25] https://www.fca.org.uk/publication/feedback/fs19-6.pdf

[26] https://www.ft.com/content/fbc6e4f7-bd89-3971-af89-7c007cb57e8c

not appear to meet the typical constraints set by the same managers for their ethical corporate bonds or equity investments that typically screen out 'sin stocks' including tobacco, gambling, weapons, adult entertainment and nuclear power.

SCM also found that various managers invest via UK and US Government Bonds despite the following facts:

I. UK Government received taxes from the tobacco industry of £8.8 Bn pa[27] during 2017/2018

II. UK Government received taxes from the gaming industry of £2.86 Bn pa[28] from betting and gaming tax receipts during 2017/2018

III. UK Government has exposure to the nuclear weapons via its Trident nuclear programme[29]

IV. UK Government has exposure to the nuclear industry given it has *"been supportive of new nuclear plants"* with 15 Nuclear Power generators in existence[30].

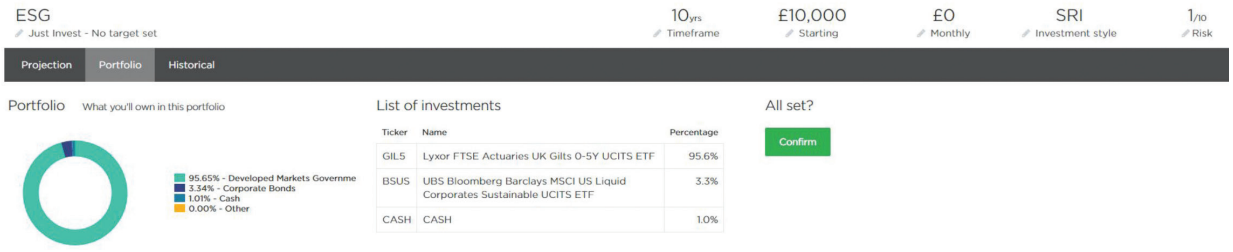
Similar, if not more worrying question marks apply to US Government Bonds, as the U.S. recently announced it would cease all participation in the 2015 Paris Agreement which aimed to reduce the emission of gases that contribute to global warming.

It would appear logical to conclude that if UK and US Government Bonds are deemed to be appropriate for an ethical fund, then every UK or US Government Bond fund should be marketed as an ethical fund, which is plainly nonsensical.

Examples of ethically based portfolios or funds with significant holdings in Government Bonds:

Nutmeg

A client choosing to invest in the lowest risk Nutmeg SRI portfolio would have **95.6%** of their money invested in a plain vanilla UK Government Bond fund and just 3.3% in a specific SRI fund (investing in bonds) as at October 2019:



[27] https://obr.uk/forecasts-in-depth/tax-by-tax-spend-by-spend/tobacco-duties/

[28] https://www.statista.com/statistics/284338/betting-and-gaming-united-kingdom-hmrc-tax-receipts/

[29] https://en.wikipedia.org/wiki/Trident_(UK_nuclear_programme)

[30] https://www.world-nuclear.org/information-library/country-profiles/countries-t-z/united-kingdom.aspx

Wealthsimple

Wealthsimple offers a conservative SRI portfolio in which **76%** (as at October 2019) is invested in UK Government Bonds even though its website[31] states:

"We invest your money across the entire stock market using a range of global SRI funds that are carefully screened and weighted for environmental, social and governance factors, as well as for performance."

Asset name	Description	Weight
UBS ETF MSCI UK IMI SRI GBP A dis	UK Equities	8.04%
iShares MSCI USA SRI ETF USD Acc	US Equities	6.96%
iShares MSCI Europe SRI ETF EUR Acc	Europe Equities	2.11%
UBS ETF MSCI Pacific SRI USD A dis	Pacific Equities	0%
iShares MSCI Japan SRI EURH ETF Acc	Japanese Equities	0%
iShares MSCI EM SRI UCITS ETF	EM Equities	1.78%
iShares Global Clean Energy ETF	Global Clean Tech	1.11%
iShares Core UK Gilts UCITS ETF	UK Govt Bonds	28%
UBS Bloomberg Barclays MSCI US Liquid Corporates Sustainable UCITS ETF	US Sustainable Corporate Bond	4%
Lyxor FTSE Actuaries UK Gilts 0-5Y (DR) UCITS ETF	UK Short-term Gilt	48%

iFunds

Within its Ethical Cautious Portfolio[32], **74%** is invested in Government Bonds, with 25% in UK Government Bonds, 26% in US Government Bonds and 10% in Japanese Government Bonds.

Portfolio allocations - 30th September 2019

Asset class	Fund (may vary from platform to platform)	%
Global Equities	UBS MSCI ACWI SRI ETF	17.0%
UK Equities	UBS MSCI UK IMI SRI ETF	8.0%
Euro Government Bonds	Vanguard Euro Gov Bond Index Fund	13.0%
US Government Bonds	Vanguard US Gov Bond Index Fund	26.0%
Japanese Government Bonds	Vanguard Japan Gov Bond Index Fund	10.0%
UK Government Bonds	iShares Core UK Gilts ETF	20.0%
UK Inflation Linked Gilts	iShares Index-Linked Gilts ETF	5.0%
Cash	Cash	1.0%

[31] https://www.wealthsimple.com/en-gb/feature/socially-responsible-investing/

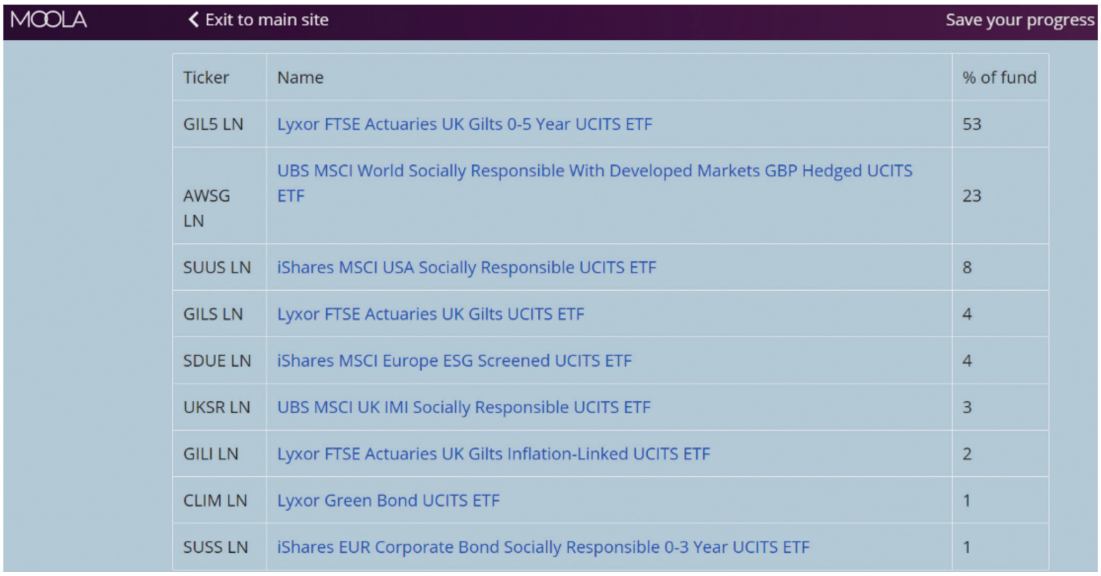
[32] https://storage.googleapis.com/wzukusers/user-19038165/documents/e4af80e3051744b8b465e81e1d3a2782/iFunds%20Ethical%20Cautious%20factsheet%20Q3%2019.pdf

Moola

In the Moola Cautious Portfolio[33], investors can expect a **59%** allocation to UK Government Bonds (as at October 2019). Their website states:[34]

"Only the leading companies are included in your portfolio. Industries considered harmful are excluded from portfolios such as weapons manufacturers, nuclear energy providers, companies involved in gambling or pornography and manufacturers of cigarettes, alcohol or GMOs."

This statement only refers to holding investments in companies rather than Government bonds.



Ticker	Name	% of fund
GIL5 LN	Lyxor FTSE Actuaries UK Gilts 0-5 Year UCITS ETF	53
AWSG LN	UBS MSCI World Socially Responsible With Developed Markets GBP Hedged UCITS ETF	23
SUUS LN	iShares MSCI USA Socially Responsible UCITS ETF	8
GILS LN	Lyxor FTSE Actuaries UK Gilts UCITS ETF	4
SDUE LN	iShares MSCI Europe ESG Screened UCITS ETF	4
UKSR LN	UBS MSCI UK IMI Socially Responsible UCITS ETF	3
GILI LN	Lyxor FTSE Actuaries UK Gilts Inflation-Linked UCITS ETF	2
CLIM LN	Lyxor Green Bond UCITS ETF	1
SUSS LN	iShares EUR Corporate Bond Socially Responsible 0-3 Year UCITS ETF	1

Wealthify (majority owned by Aviva)

Within the Wealthify Cautious Ethical Portfolio[35], investors currently have **52%** invested via UK, US and European Government Bonds (as at October 2019).

[33] https://moo.la/explore/dash

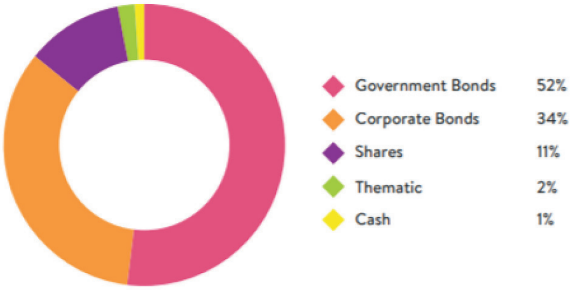
[34] https://moo.la/ethical

[35] https://invest.wealthify.com/CreatePlan/FactSheet/c07b871c-1735-4f52-a032-7ccae4463cf5?file=pdf

Investment	Type	% of Plan
iShares US Short-term Government Bonds Hedged	Government Bond	25%
Royal London Short Duration Government Bonds	Government Bond	24%
Vanguard Euro Government Bonds	Government Bond	3%
Royal London Ethical Bond	Corporate Bond	8%
Rathbone Ethical Bond	Corporate Bond	8%
Royal London Sustainable Managed	Corporate Bond	8%
Edentree Amity Short Duration Bonds	Corporate Bond	3%

Investment Mix

This is a typical example of the mix of investments in an Ethical Cautious Plan.



M&G

M&G's Sustainable Multi Asset fund[36] states that its *"Assets are selected that meet the fund manager's ESG (using an ESG-screening approach) or impact criteria"* but SCM could not find within M&G's marketing materials as to how such principles were applied to Government Bonds.

As at the end of April 2019 it held c. **31%** in Government Bonds:

- 6% in European Government Bonds
- 15% in US Government Bonds
- 10% in other Government Bonds.

[36] https://www.mandg.co.uk/investor/funds/sustainable-multi-asset-fund/gb00bhr41h73/

Classification of investments

The table below shows the percentage holding per sector.

	% of fund as at 30.04.19
EQUITIES	
United Kingdom	
UK equities	3.47
Europe	
European equities	16.92
North America	
North American equities	9.51
Japan	
Japan equities	12.23
Asia pacific (ex Japan)	
Asia Pacific equities	7.51
Other	
Other equities	2.46
FIXED INCOME	
Europe	
European Government bonds	5.75
Europe investment grade corporate bonds	0.91
North America	
North American Government bonds	15.30
North America investment grade corporate bonds	4.14
Global	
Global fixed income funds	1.91
Other	
Other Government bonds	10.45
Other investment grade corporate bonds	0.46
Other Interest rate futures	(0.13)
CURRENCY	
Forward currency contracts	1.09

Asset Class Allocation

	%
Sterling Equities	57.32
Sterling Index-Linked	37.20
Sterling Government Bonds	3.80
Cash	1.68

AXA

AXA's Ethical Distribution Fund[37] held nearly 42% of its fund in UK Government Bonds (including index-linked bonds) in October 2019. AXA states[38] that it:

"adheres to a strict ethical investment methodology, screening companies on a range of criteria, in order to determine their suitability for investment" and "also invests in bonds issued by the UK government (gilts), including index-linked gilts, and cash. The screening process only applies to equity holdings (companies) in the portfolio, not to government bonds."

[37] https://retail.axa-im.co.uk/document-viewer/-/documents/download/axa_b2c_9161_en

[38] https://retail.axa-im.co.uk/documents/26049/3050092/AXA+Ethical+Distribution+Fund+-+Ethical+Principles+document+update+-+Jun....pdf/5d212b70-5a22-c9d7-8943-e19d7a87268b

5. Various funds, classified as being "ethical", found to be investing significant amounts in tobacco, alcohol, gaming and defence stocks

SCM recognises that it is not uncommon to have small exposures to stocks within the tobacco, alcohol, gaming and defence sectors within ESG/SRI funds but was surprised to find several funds in which the total amount invested in such activities amounted to 5% or more of the fund.

L&G Future World ESG UK Index[39]

"Invests in shares of UK companies as represented by the Index, which is alternatively weighted to give greater weight to companies that score well against environmental, social and governance criteria. This means the Fund will invest more in companies that score well against these criteria, and less in companies that do not."

The fund as at 31st August 2019, according to Bloomberg, 11.4% of the fund was invested in tobacco, alcohol, gaming and defence stocks.

Legal & General Future World ESG UK Index fund	%Weight
Gambling (Non-Hotel Casinos)	
WILLIAM HILL PLC	0.08
Internet Gambling	
GVC HOLDINGS PLC	0.12
888 HOLDINGS PLC	0.01
Beverages - Wines/Spirits	
DIAGEO PLC	5.25
Brewery	
MARSTON'S PLC	0.03
Aerospace/Defence	
BAE SYSTEMS	0.64
MEGGITT PLC	0.17
ROLLS-ROYCE HOLDINGS PLC	0.68
Aerospace/Defence - Equipment	
COBHAM PLC	0.18
Tobacco	
BRITISH AMERICAN TOBACCO PLC	3.05
IMPERIAL BRANDS PLC	1.16
Electronics - Military	
ULTRA ELECTRONICS HOLDINGS	0.06
TOTAL	**11.43**

[39] https://www.legalandgeneral.com/investments/funds/full-fund-range/future-world/future-world-esg-uk-index-fund.html

Vanguard SRI European Stock Fund[40]

"The Fund employs a passive management or indexing investment strategy designed to achieve the performance of the index, by investing in all, or a representative sample of, index securities that satisfy the application of a screening process for socially responsible investing. The Fund will not hold stocks of companies in the index that do not meet specific "socially responsible" criteria."

According to Bloomberg, this fund as at 31st August 2019, had 5.7% of the fund invested in alcohol, gaming and defence stocks.

VANGUARD INV SERIES PLC SRI EUROPEAN STOCK	%Weight
Gambling (Non-Hotel Casinos)	
FLUTTER ENTERTAINMENT PLC	0.03
Internet Gambling	
GVC HOLDINGS PLC	0.04
Beverages - Wines/Spirits	
DAVIDE CAMPARI-MILANO SPA	0.04
DIAGEO PLC	1.42
PERNOD RICARD SA	0.61
REMY COINTREAU	0.06
Brewery	
ANHEUSER-BUSCH INBEV SA/NV	0.86
CARLSBERG AS-B	0.14
HEINEKEN HOLDING NV	0.14
HEINEKEN NV	0.35
Aerospace/Defence	
MEGGITT PLC	0.43
MTU AERO ENGINES AG	0.53
ROLLS-ROYCE HOLDINGS PLC	0.40
SAAB AB-B	0.17
Aerospace/Defence - Equipment	
COBHAM PLC	0.45
TOTAL	**5.67**

[40] https://www.vanguardinvestor.co.uk/investments/vanguard-sri-european-stock-fund-accumulation-shares/portfolio-data

Morgan Stanley Global Brands Fund[41]

The Morgan Stanley investment policy seeks

"to engage with management teams to assess relevant factors material to long term sustainable returns including environmental, social and governance (ESG) factors. The Investment Manager will retain discretion over which investments are selected and ESG factors may not be the sole determinant for selecting an investment."

The fund's third largest holding as at the end of September 2019[42] was the tobacco company, Philip Morris:

Top Holdings (% of Total Net Assets)[4]	FUND	INDEX
Microsoft Corp	8.06	2.45
Reckitt Benckiser plc	7.61	0.13
Philip Morris Inc	6.83	0.29

5.1 Examples of unusual filters being used for 'ethical' funds

Example 1 - Timothy Plan Fund[43]

- **Marriage** – This screen filters to recognize companies that affirm the marriage covenant – 'a sacred bond between a man and a woman instituted by and publicly entered into before God.'
- **Life** – This screen seeks to protect the life of the unborn by screening out companies involved in the abortion industry, including foetal tissue research and the manufacturing and distribution of abortifacients.

[41] http://docs.publifund.com/kiid/GB0032482498/en_GB

[42] https://www.morganstanley.com/im/publication/msfundsuk/factsheet/fs_msfundsuk_globalbrands_iacc_en.pdf?1568301159889

[43] https://timothyplan.com/download/eVALUEator_Moral-Audit_Sample-Report-Popular-Mutual-Fund.pdf

Violation Overview

hide

Microsoft Corp.

MSFT *NASDAQ |

One Microsoft Way Redmond, WA, U.S.A. 98052-6399
4258828080 | www.microsoft.com

ABORTION | **Philanthropy**

Providing charitable aid or donations to non-profit organizations which include foundations that pay for abortions, provide emergency contraception pills, birth control pills and/or pursue "reproductive freedom", like Planned Parenthood, to everyone, regardless of age.

ENTERTAINMENT | **Advertiser**

Sponsors contribute to the culture of television, either positively or negatively by choosing which programs they support with their advertising dollars. In choosing to spend money on some of the most egregious content on broadcast television, they are supporting shows containing sexually graphic, violent or profane material and ultimately undermine the positive values parents are trying to instill in their young ones.

ENTERTAINMENT | **Games**

Publishes physical games and/or computer/video games that are sometimes considered controversial, due to the depiction of graphic violence, sexual themes, adver-gaming (a form of advertising in games), simulated gambling, consumption of drugs, consumption of alcohol or tobacco, profanity, propaganda (including same sex encounters), satanic, witchcraft, or anti-Christian themes.

LIFESTYLE | **Legislation**

Supports federal legislation that affects the lives of lesbian, gay, bisexual and transgender Americans.

LIFESTYLE | **Philanthropy**

Providing charitable aid or donations to non-profit organizations that include foundations actively pursuing and advancing the alternative lifestyle movement.

LIFESTYLE | **Promote**

Uses one or more methods to promote gay, lesbian, bisexual, transgender/transsexual, or questioning lifestyles (GLBTQ). This may include advertisements or marketing campaigns targeted to those who choose alternative lifestyles, proudly display or boast being "gay-friendly", and/or provide resources for the advancement of GLBTQ groups (meeting places, materials, etc).

LIFESTYLE | **Sponsor**

Has formed a business relationship with GLBTQ (gay, lesbian, bisexual, transgender/transsexual, and/or questioning) organization(s) or events. In an attempt to gain marketing and community relations opportunities, money, products or services are exchanged for corporate recognition for their involvement.

PORNOGRAPHY | **Games**

Publishes computer and/or video games that contain graphic sex or nudity.

Example 2 - SUNARES - Sustainable Natural Resources[44]

Following the ancient Chinese concepts, SUNARES has divided the world of investment into two parts: Yin and Yang, which are binary reciprocal actions for all life on Earth. The 'yin' symbolises the shady side of the mountain and is associated with the basic elements of earth and water, along with the 'female' principle. Conversely, 'yang' stands for the sunny side of the mountain, which is connected to the elements of fire and air (the 'male principle').

The central thesis and basis of SUNARES is the belief that this natural balance of the four basic earthly elements has very much lost its balance due to a disproportionate increase in the 'yang' sector (this concerns all the industries associated with fire and air).

[44] https://sunares.com/document/356

6. Research found significant underperformance against the average actively managed ethical equities fund

SCM analysed 530 ethical mutual funds with a combined total asset of $207 Bn* and 57 ethical ETFs with a combined total asset of $34 Bn*, defined by Bloomberg as ethical mutual funds, with an inception date prior to 30/06/2016.

Only primary share class were selected and funds that had no comparable market cap index (such as Gender equality funds) were removed.

The closest available MSCI Index was used as a market cap proxy, save in the following:

a) US Small Cap - Russel 2000 Index used

b) US Mid Cap - Russel Mid Cap Index used

c) US Large Cap - S&P 500 Index used

d) US Broad - Russel 3000 Index used

e) UK Broad Market - FTSE UK All Share Index used

f) Japan 400 (if stated) - JPX Nikkei 400

* As at 02/09/19

SCM Direct found that the average Ethical Equity mutual fund underperformed the market by 2.5% per annum over the three years to end June 2019, compared to 0.8% per annum for the average passive ethical equities fund.

Our view is that the extra underperformance is largely attributable to the significantly higher charges levied by a typical actively managed ethical fund.

	30.06.16 - 30.06.17	30.06.17 - 30.06.18	30.06.18 - 30.06.19	Annualised
Ethical Equity Mutual Funds	18.1%	8.6%	2.0%	9.3%
Equivalent Market Cap Indices	20.0%	11.1%	4.9%	11.8%
Difference	**-1.9%**	**-2.5%**	**-2.9%**	**-2.5%**
Ethical Equity ETFs	20.1%	8.7%	0.9%	9.5%
Equivalent Market Cap Indices	20.5%	10.0%	1.5%	10.3%
Difference	**-0.4%**	**-1.3%**	**-0.6%**	**-0.8%**

Conclusion

The ethical fund industry is a fast-growing both in terms of the amounts invested and the number of funds available.

The FCA recently said[45] that:

"We will challenge firms where we see potential greenwashing and take appropriate action to prevent consumers being misled."

Given that investors have chosen to invest their money with extra ethical considerations, it is shameful that the investment industry is prepared to pay lip service to such considerations to gain assets and fees, and even more shameful that the UK regulator[46] does not appear to have taken any action against firms greenwashing and thereby meet its strategic objective to ensure that markets function well and its operational objective to protect consumers.

Investors deserve better from the industry and regulator alike.

[45] https://www.fca.org.uk/publication/feedback/fs19-6.pdf

[46] https://www.handbook.fca.org.uk/handbook/glossary/G2976.html

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