Checking your thinking – the importance of independent oversight

Mike Fox, Head of Sustainable Investments at Royal London Asset Management, explains the importance of an external advisory committee

Fund managers tend to get the limelight, yet we wouldn't achieve much without the support of a team of bright, talented and multi-disciplinary people. George Crowdy (co-manager of the recently-launched RL Global Sustainable Equity Fund) and I work closely with the wider responsible investment team, which helps us to look at sustainability issues, corporate governance and building the long-term engagement that encourages positive corporate behaviour thereby aiming to enhance investment returns.

The team has a very flat, collaborative structure in which everyone has an equal vote as to whether a company is eligible for our funds. Managers need to be challenged and 'group think', even if unintentional, is disastrous in any decision-making process. So diversity of opinion is not just encouraged, but actually required. There are times, however, when we just cannot come to a conclusion on an issue, maybe because there is no precedent or we cannot agree on the best way forward. At this point we bring in our external advisory committee.

What is the advisory committee?

If you run a sustainable fund, you can buy in third-party research and effectively 'outsource' decisions about the sustainability of each investment. Or you can do much of the research yourself, as we do, and be fully responsible for those decisions. We prefer the internal model as we think it is more flexible and gives better research insights.

If you opt to do your own research, you need some form of oversight. Fund managers could be susceptible to inherent biases towards something that is financially attractive, but sustainably less sound. Our internal structure is designed to offset this, but our advisory committee is there as an extra check to challenge us, help to ensure we act in the spirit of our sustainable funds – as well as to share its knowledge and experience.

It is external, comprising four specialists with complementary expertise from the academic, corporate, client and investment worlds relevant to sustainable investing. It is also independent – of me and the team, and of Royal London as a whole. It meets three or four times a year and can also meet virtually, which is helpful in the current challenging environment. Financial markets move fast, so if everybody internally is in agreement on an investment, we can invest in a security. However, at its next meeting, the advisory committee can assess those decisions. If the committee disagrees with us, we would have to take the relevant investment out of the funds. That's not something any fund manager wants, so we don't sail close to the wind.

We focus the committee's time on the controversial, difficult stuff. That's either where we can't agree internally whether individual companies meet our sustainable investing criteria; or for complex issues without a precedent, where

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we want a framework to guide our thinking. For example, we get asked about fossil fuels a lot, but the questions are often vague. It isn't clear what is meant by 'fossil fuels': extraction, power generation or services companies?

Working with the advisory committee, we formulated a policy to address each of those areas. The outcome is that fossil fuel extraction is straightforward – we don't own any oil, gas or coal-mining companies. However, we will consider power generation utilities with a bias towards renewables and with a clear strategy to increase this share over time.

The new global sustainable equity fund

We felt a global sustainable equity fund couldn't really exclude China, South Korea, India or the leading countries in South America. It seemed odd to exclude emerging markets. So we asked the committee to help with a framework around sustainable investing in emerging markets.

Chinese technology was an interesting area. I may have invested here, but the committee thought otherwise. They cited state censorship and corporate governance, and the latter proved to be an insurmountable barrier. Corporate governance is always our first consideration, whether for an individual company or at a national level. Their rationale made good sense. Although it's an 'advisory' committee, in 17 years since I joined, we haven't gone against their advice.

We've also discussed the issue of relative and absolute sustainability standards. There is a view that these standards must be lower in emerging markets. They can be, of course, but they can also be higher – look at how South Korea has dealt with the coronavirus outbreak.

It helps to understand that different standards apply between all countries, even within developed markets – consider the diversity of Japanese company boards, for example. The point is how much flexibility can you accept without compromising the values of the fund? Such subjective questions illustrate perfectly why we have an external advisory committee.

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Find out more about our range of sustainable funds – including the recently-launched RL Global Sustainable Equity Fund – at rlam.co.uk/sustainable

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