McInroy & Wood

PERSONAL INVESTMENT MANAGERS

Statement on Responsible Investing

June 2018

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The firm pursues its clients' investment objectives in full awareness of its responsibilities. We view these responsibilities as a continuing obligation over the span of generations. That means that we require to consider the implications for society as a whole of what we do and how we behave. Staff and directors consider that enduring prosperity for clients and firm alike cannot rest on narrowly framed commercial objectives.

The following narrative sets out how this firm discharges its responsibilities. There can be no compromises in the effort to sustain ethical priorities. Nor are there short cuts on the journey towards an embedded culture. We ask readers to regard the Policy features section merely as an indicator of our direction of travel. We hope it will encourage them to 'join the dots' in the narrative that follows below. Only the whole narrative makes real what might otherwise be simply pious assertions.

Policy features

- Achievement of clients' objectives relies on *three contributing factors:*

  – **professional competence** and demonstrable technical ability;

  – **a determination to apply that competence in ways broadly sympathetic to the interests of the wider society** in which we live and work;

  and

  – **a culture within the firm** which recognises the intrinsic worth of principled behaviour.

- The firm has always taken a holistic view of its responsibilities to clients and to wider society. In the long term the two are inseparably connected.

- For this reason ethical considerations govern all we try to do – externally and internally. Ethical conduct can have no boundaries.

- Ethical concern affects our relationship with companies, our relationship with our clients, and the conduct of our internal affairs.

- Technical competence alone is insufficient to create sustainable success. Wider qualities of discernment and coherence are crucial.

- Application of ethical standards is only valuable if it achieves practical results.

- Investment 'ostracism' is a useful sanction but it is a blunt instrument. Other ethical responses may be more effective.

- Specific company issues may be important. But so are wider issues which have a relevance for society as a whole. Some we have been concerned about include financial education, marine pollution, sensible regulation, exploitative marketing and financial sector remuneration.

- The internal culture of the firm and its inner working needs to earn acceptance by, and the affirmation of, all stakeholders in our activities.

- Directors and staff alike must own the same culture.

- Many of the results of the firm's response to its ethical concerns may only become visible in the long term. However, a long-term outlook is customary in the firm's efforts towards enduring sustainability.

- We have developed, discussed and written publicly about our ethical concerns for over 30 years.

In sum, our work towards achieving clients' objectives and our own continuing prosperity ultimately rests on its sustainability. Its sustainability has to be reflected in replicable investment process, the continuing satisfaction of our clients and the affirmation of the community at large. All are crucial to securing our objectives from one generation to the next.

Professional competence

From a technical point of view, the firm regards competence as simply the means of achieving a finite objective. It is morally neutral. Competence can in part be evidenced, like any professional skill, by various objective yardsticks, for example formal qualifications and the record of achievement. However, as in the case of a surgeon or lawyer, it should be presumed, not claimed as a special attribute.

The firm lays store by its competence to invest directly across the world's markets. Our investment staff draw on a deep well of experience in global investing. We have chosen as a matter of principle to invest directly. That enables us to retain full control over every client's investments. It also enables us to monitor directly any given investee company's behaviour. No such control is available when client funds are sub-contracted to other parties. Management responsibility, in our view, entails retaining full and direct control. It also entails a duty to minimise client costs so far as practicable. Sub-contracted management will increase client costs.

To be sustainable, investment practice must be capable of navigating its way through an infinite variety of economic hazards. Only to a very limited extent can such a capacity be demonstrated by statistical history. Enduring success relies far more on a coherent and clearly articulated investment narrative. Risk assessment as well as potential reward forms an important part of this firm's approach. Our investment team draw on two supportive factors in forming their risk assessments: firstly, long collective experience of investing in global investment markets; secondly, familiarity with the inter-generational interests of clients and the long-term horizon required to safeguard them.

These factors underpin the firm's consistency of approach and achievement. Both enable us to found our investment work on sound value judgements and an ability, we trust, to discern the investment factors relevant to current circumstance.

A long-term horizon helps establish realistic investment objectives. Pursuit of these by appropriate means clears the path towards sustainable achievement.

Interests of wider society - ethical principles in practice

Social responsibility and ethical investing are simply different aspects of the same issue.

The acid test for any ethical investment policy is whether it can be seen to make a difference for the better; whether ethical standards applied really improve things in practice. If a claim to uphold ethical principles cannot prove itself in the field of hard choices, tough decisions, and personal sacrifice, it won't be worth much.

We have given careful thought to these matters. For more than a quarter of a century our whole approach to ethical issues has been based on consideration of how best we could make a difference to the world in which we practise. Our social concern is unchanged since the inception of the firm over 30 years ago. It consists of several closely connected strands.

The first of these is to focus on narrowly defined areas of concern. Our response to such concerns may ultimately involve investment exclusion. Our standard procedure is to review the operations of any company (or investment category) under consideration for activity potentially hurtful to consumers, wider society and the environment. Companies exhibiting evidence of such activity may be excluded from consideration for (continuing) investment. In our own case tobacco companies and arms manufacturers have been two such sectors which we have, as a matter of principle, long chosen to avoid. Our ethical concerns may extend to commercial or industrial companies as a group and in such cases whole categories may also be avoided. Companies involved as a group in usurious lending would fall into such a category. So would the gambling sector.

Secondly, we have occasionally made specific ethical concerns known directly to executives of investee companies; this was done, in one case, over the issue of the exploitative marketing of alcopops, and in another over the unjustifiable remuneration of directors. In a third case we warned the partner of an investment management group managing an investee company about inappropriate reliance on the 'star' status of an individual (rather than the qualities of the management firm as a whole). Generally we prefer to influence conduct as active and concerned shareholders, though we have on occasion disengaged from companies because of a particular concern, for example over exploitative baby milk marketing.

Hurtful impacts of corporate behaviour on wider society may often be better addressed at government and consumer policy levels. Such concerns may be best expressed in collaboration with other like-minded investment shareholder groups or their trade bodies. The firm is actively engaged in making representations of concern over the environmental damage wrought by microplastics. The firm is a member of The Investor Forum. It thus has access to a powerful body capable of exerting a considerable collective influence on corporate conduct.

Problems arise, however, when principles of ethical governance are framed simply to exclude, as if to keep the enemy out: by distancing a potential investor from, for example, tainted profits or by disengaging from contact with oppressive regimes or any other area exhibiting signs of harmful behaviour. High-minded detachment, for all that it sends a useful signal about the bounds of acceptable business practice, often fails to stand up to logical scrutiny. Where in the supply chain does responsibility for the manufacture of arms cease? At the point of manufacture, with the component supplier, or with the metals producer? Is a huge company, with a small but vital operation in a country with a questionable regime, less culpable than a small one whose entire production is sited there? What is one to make of the drinks trade when there is evidence to suggest that alcohol in moderation can be good for you? Is money distributed by the National Lottery less objectionable than the proceeds from betting?

Investment sanctions may help support an ethical framework but they are insufficient because, like economic sanctions, they are often ineffectual. They may not make any real difference to the interests of wider society.

Thus the third strand of our effort to take full account of the interests involved relies on the force of argument and the power of the written word. An ethical case can be persuasively presented by these means and to powerful effect. A firm such as ours keeps contact with a wide circle of conscientious and sensitive readers. Many are keenly alert to ethical investment issues. Since our inception we have sought to lay before them short essays, either directly or through professional periodicals. These have addressed many ethical concerns including *"short termism" in business; ecological conflicts; the responsibilities of institutional investors; co-operation as a basis for prosperity; the natural limits to growth; striking a fair balance in reward differentials; and ethical dilemmas in investing.* The series is contained in our book "Grown from Home" published in 2013. It is available upon request, as are essays published since then.

Fourthly, we believe that we have a responsibility to tackle issues of national importance that bear upon the conduct of the investment industry. In this context the firm has spent considerable time and effort in putting together a programme for providing sensible financial education in our schools. The resulting paper has been presented to high-level policy makers and others. In the same vein the firm is actively contributing to efforts to help arrest pollution of the marine environment, in particular the processing and manufacture of plastic (see above). Our thoughts in this area have been set out in our (collective) letter to the British Retail Consortium which we initiated. Other leading investment management firms with similar concerns attached their names to it.

Fifthly, we strive to make financial regulation more effective, particularly when it bears upon the exploitation of the most vulnerable. Regulation alone, however, will never suffice to engender integrity of purpose across the business community.

Culture within the firm

Ethical investing will never contribute much to business life if its adherents require of others standards they do not uphold themselves. The voice of an investing institution will not be heard if it indulges its own irresponsibilities while complaining about those of others. Such inconsistencies convince us that the goal of ethical conduct must be pursued as strenuously within internal areas where one has direct personal responsibility as in external ones where the conduct of others can only be examined objectively and at a distance. Ethical conduct can have no boundaries. Without street credibility built on visible integrity of approach, little is achievable.

Credibility cannot be cooked up by recipe or evidenced by observance of some formulaic code. It reveals itself in an attitude of mind and a readiness to pull against the tug of self-interest.

The culture of this firm is crucial to its enduring sustainability. Only if that culture wins justifiable affirmation from both its clients and the wider community can it be considered sustainable. The directors and staff alike have sought from the beginning to cultivate the qualities necessary to justify the firm's reputation over generations.

1. We have from the beginning sought to inculcate across the firm a thorough grasp of our priorities. In particular we explain to each staff member the connection between personal behaviour and the firm's enduring prosperity. At weekly meetings every staff member is expected to contribute directly to our undertakings. Each is encouraged, for example, to reduce the pressures of work by open sharing of difficulties; and each is expected to air ideas for operating improvements and for mitigating risks. Most staff are located in the firm's headquarters in Haddington and the directors make every effort to build a collegiate atmosphere. Visitors observe that this is a visibly happy place of work.

2. Staff are fairly remunerated and, on a discretionary basis, receive a share of the firm's profits. Bonuses have never been paid since directors acknowledge that every employee is already using his/her best efforts towards fulfilling their appointed responsibilities.

   The directors are paid salaries which are moderate by City standards. These comprise their sole remuneration. All participate in the fruits of their efforts by virtue of a shareholding. The controlling family are also committed long-term shareholders and guard the firm's independence zealously.

3. The firm does not rely on promotional efforts to win new clients. Nor does it buy new client relationships by company acquisition. New relationships are generally initiated by potential clients themselves; the firm does not advertise other than in connection with its various charitable activities. Nor does it stage speculative assemblies of target customer groups for marketing purposes. The directors believe that the character of the firm's client relationships contributes substantially to their sustainability.

4. We have always tried to treat our customers honourably and fairly, irrespective of more recent regulatory requirements to do so. In particular we are careful to avoid potential conflicts of interest. We have never accepted remuneration generated by discretionary transactions. We do not discriminate against poorer (potential) clients by accepting only rich ones. We aim to help any that approach us. In preserving strict independence, we believe we are better placed to avoid such conflicts.

5. Our aim throughout the firm is to demonstrate to staff the moral worth of what each does so that each comes to value their work for its own sake. Once staff understand this they are far better motivated to serve clients' interests. Clients appear to recognise the enthusiasm of our staff for their work.

6. We are deeply appreciative of the local community surrounding our base in Haddington. Our responsibilities to wider society begin with due acknowledgement of the social and cultural fabric of our own community. For that reason we contribute significantly to the creative arts and other community interests. The support and appreciation of our community is no less important than that of other stakeholders in setting the operation of the firm on a sustainable basis.

The results of our endeavour can't be directly quantified in the world outside. At first glance, that shortcoming might cast doubt on its practical worth. But shaping a culture, changing attitudes, is a gradual process. What can already be directly attributed to our efforts is the appreciation of our clients, friends and, we believe, a wider community. That goodwill evidences a respect for the principles we have tried to apply. Undoubtedly it has assisted the growth of our practice and in that sense treating clients well has brought long-term benefits for our firm as a whole. We have much to be grateful for. But approbation reinforces our efforts only insofar as it strengthens a conviction that they are worthwhile for their own sake.

In summary, we see responsibility for our internal conduct, our interactions with society and our contribution to good practice within the financial community not as ancillary obligations, sidelined to a separate compartment, but an integral concern that should lie at the heart of our thinking. It does so and we believe the evidence supports that claim.

Signed for and on behalf of McInroy & Wood:

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