CCLA
GOOD INVESTMENT

Our values-based screening policy

How we align our portfolios with the values of our clients

As the guardians, not the owners, of assets that we manage we seek to ensure that our portfolios are aligned with our clients' objectives, values and beliefs. One way that we do this is through the implementation of values-based screens.

Values-based screens seek to identify companies that our clients wish to avoid and exclude them from our investment universe. There are three types of values-based screens that we implement in the management of our clients' assets:

- **Product-based screens**. These identify and restrict companies based upon the products that they produce or the services that they offer. An example of a product-based screen is one that restricts companies from investment if they are a tobacco producer.
- **Conduct-based screens**. These apply to all companies, irrespective of what they produce, and target companies that fall behind expected standards of behaviour. An example of a conduct-based screen is one that restricts companies from investment if they have a poor environmental, social and governance (ESG) rating provided by an external rating agency.
- **Engage–divest screens**. These screens are designed to improve company policies and practices but also lead to restriction if no progress is made. An example of an engage–divest screen is a company that faces an allegation of non-conformance with the UN Global Compact. To correct the issue, companies are encouraged to remediate the damage caused and/or develop policies and processes to avoid a recurrence of the issue through engagement. The companies are divested from however, after a period of time, if sufficient changes are not made.

Each of these types of values-based screens are calibrated in two ways based on the level of client concern:

- '**Any involvement' screens**. These restrict companies if they have any involvement in an activity proscribed by our clients. As these are implemented irrespective of the size of the companies' exposure to the activity they are usually reserved for the most problematic issues. An example of an 'any involvement' screen is restricting companies that have exposure to the production of cluster munitions.
- '**Materiality-based' screens**. These restrict companies if the restricted activity makes up more than a specified proportion, commonly 10%, of their entire revenue. The aim of a materiality-based restriction is to effectively target companies who focus on the production of prohibited products. An example of a materiality-based restriction is one that restricts companies if they generate more than 10% of their revenue from the production or retail of alcoholic drinks. This identifies and restricts alcohol producers, like Diageo, from investment whilst leaving diversified retailers, like supermarkets, eligible.

How we create values-based screens

Our clients have different values-based investment priorities. To reflect this diversity of opinion, whilst all our funds are based on common investment approaches, we implement different values-based screens in our product offering. These are based on rules that are either set, directly or indirectly, by our clients. The process that we undertake to set these screens differs on a fund-by-fund basis.

- **For the COIF Charities fund range**, the values-based investment policies are set by the funds' trustees. This process is informed by CCLA's consultation process which takes place every three years with unitholders and the COIF Charities Ethical Investment Fund's dedicated Advisory Committee.
- **For the CCLA Catholic Investment Fund**, the policies are set by CCLA with the assistance of the fund's dedicated Faith-Consistent Investment Committee.
- **For the CBF Church of England fund range**, the screens are developed by CCLA to meet the unitholders' desire to invest in a way that reflects Christian and Anglican teachings and is grounded in the advice produced by the Church of England's Ethical Investment Advisory Group.
- **For the segregated investment management services**, clients have the option of setting their own bespoke values-based investment policy based on the menu of criteria offered by CCLA.
- **For the Better World Global Equity Fund and the Cautious Multi-Asset Fund** policies are set by CCLA.
- **For the funds for local authorities**, the policies are set by CCLA based on our ongoing assessment of the requirements of the sector.

How we apply values-based screens in listed equity

Recognising their different characteristics, values-based screens are applied in different ways for different asset classes.

In listed equity, we subscribe to data provided by external data providers who research the business activities of over 9,000 companies. Looking at the whole of the investment universe, this allows us to benefit from objective and wide-ranging assessments of which companies are involved in which business practices.

The resulting data is matched to the values-based screens that are implemented in our funds and portfolios allowing us to identify and restrict investment in businesses that breach our clients' requirements. To protect against errors, this data is subsequently programmed into our order management system, which acts as a barrier to any trade that would breach a values-based screen.

Whilst most listed equities are covered by our data providers, we occasionally wish to invest in a company that is not within their data universe. One example would be companies that are listing on public markets, through an initial public offering, for the first time. To ensure that these businesses comply with the values-based screens operated by our funds and portfolios, we commission one of our providers to carry out a bespoke review, which, when it is completed, is cross-checked by CCLA's specialist team. Once this review has been completed, these companies require the approval of CCLA's Investment Committee before they are considered to be eligible for any account.

Due to the specialist nature of investing in funds that are managed by other investment managers, such as real estate investment trusts or exchange-traded fund, these are subject to a different screening process.

How we apply values-based screens in fixed income

We also use data provided by our external providers to implement our values-based screens in the management of our Short Duration Bond funds. However, as the potential universe of fixed income issuers is wider than our listed equity data coverage, we have developed two further processes.

1. Fixed income securities are often issued by unlisted subsidiaries of businesses. This means that whilst the issuing entity is often not covered by our data providers, their parent company is. To allow for this, we use data provided by Bloomberg to link these entities to, and then screen them against, their parent company. This is coded into our order management system, thus allowing effective screening.
2. There are a large number of issuers of fixed income securities that are not listed, are unconnected to a listed business, and, due to their size, are not covered by our data providers or are outside CCLA's data subscription. In the UK, for example, this includes building societies. To ensure that these comply with our values-based screens, these entities are screened by our in-house specialist team.

How we apply values-based screens in property

To implement this policy, we seek to screen properties prior to investing in them. We do this by assessing the activities undertaken by the underlying tenants. This means that if the activities undertaken by the occupiers of a property breach one or more of our values-based screens we do not proceed to investment. For this reason, a property can breach a values-based screen, and be considered an ineligible investment, in one of two ways:

1. If any of the tenants is involved in an activity proscribed by an 'any involvement' screen it would be restricted. For example, this approach would apply if a tenant were to be identified as producing cluster munitions.
2. A property would be ineligible if the collective revenue derived from all of the tenants breaches a materiality-based screen. For example, if a tenant in a multi-let property were to derive over 10% of the collective rental yield from an activity that breaches a materiality-based screen then the property would be restricted irrespective of the activities conducted by the other occupiers.

In conducting the assessment of tenants, we seek to use the data provided by our external suppliers. However, due to the nature of property investment, very few prospective tenants are within the data coverage of these providers. For this reason, most tenants are subject to an in-house desk-based assessment. This is conducted on a 'best endeavours' basis. As a further safeguard all new property investments are subject to the approval of CCLA's Investment Committee prior to being acquired for one of our funds.

We continue to apply the funds' values-based screens post investment. Where possible we review new tenants against the funds' criteria and seek to avoid entering into leases with businesses that conduct activities that are proscribed by the funds' values-based policies. However, as per standard practice in property investment management, we do not include restrictive clauses within the leases that are granted to tenants as they significantly impact upon the economic value of the asset. This means that existing tenants can pass on their lease to another business without our approval. For this reason, it is possible that, post-acquisition, a property can move into a position where it is no longer in compliance with the funds' values-based screens. Should this occur, we assess the situation and develop an action plan on a case-by-case basis.

How we apply values-based screens in third-party managed funds

To ensure that we can implement our clients' values-based screens we seek to invest most of our assets directly. This allows us to exercise direct control over the selection of investments. However, to provide the investment returns required, within an acceptable risk budget, it is necessary for us to invest in specialist asset classes, such as private equity and infrastructure, where we do not have the expertise to gain direct exposure in a way that is fair to our clients ourselves. To do this we use externally managed investment products.

Our external data providers have not been able to deliver comprehensive screening of fund-based investments. For this reason, we have developed an in-house approach to screening these vehicles[1] against our values-based investment policies.

Our starting point is to seek to enter into an agreement with the relevant investment manager. These agreements seek to ensure that the fund does not invest in restricted activities or that CCLA clients' capital is not exposed to any such investments that are made.

Should it not be possible to enter into an agreement, we undertake our own desk-based screening process. Prior to an investment in any third-party managed fund, CCLA's specialist team seeks to review all of the underlying exposures held within the product. On the back of this review each third-party managed product is assessed against the values-based criteria adopted by CCLA's clients. Through this assessment third-party managed funds are deemed to be ineligible for our clients' portfolios if:

- any of the underlying holdings are identified by CCLA as being exposed to companies involved in the manufacture of weapons that are banned by international treaties (for example, a fund would be ineligible for any CCLA product if an underlying investment is identified as providing critical parts to a cluster munitions system)
- 10% or more of the underlying capital value of the fund is dedicated to activities proscribed by the CCLA products' values-based investment policy (for example, a fund would be ineligible for the COIF Charities Ethical Investment Fund if over 10% of the potential investee fund was exposed to companies that manufacture tobacco and alcohol).

All new third-party fund investments require the approval of CCLA's Investment Committee prior to investment for any CCLA product.

Once invested, funds are monitored to ensure that they remain in compliance with these rules. As a final safeguard, we seek to ensure that the combined exposure to all restricted activities within our third-party managed fund holdings remains below 1% of the capital value of the CCLA fund.

Third-party fund reviews are labour intensive, and it is often not possible to obtain all of the necessary information. For example, some private equity funds invest in other funds that do not disclose all their holdings. For this reason, our screening of third-party managed funds is undertaken on a 'best endeavours' basis.

1 For the sake of our values-based screening process, CCLA defines an investment fund as being 'An investment where CCLA seeks to be a participant in a collective pool of capital that is used to purchase investment assets'. This includes entities such as investment trusts, real estate investment trusts, property funds, open-ended investment companies, and exchange-traded funds. As such this definition does not include companies that manage financial products, such as private equity investment managers. These are considered to be listed equities and are screened using the data, definitions and exclusions provided by third-party data providers.

Divestment window

Should a fixed income or listed equity holding move to a position where it is no longer in compliance with a values-based screen, CCLA will divest the holding within six months. This ensures that our clients are not financially disadvantaged by becoming forced sellers. Due to the illiquid nature of other asset classes, exposures that are no longer compliant will be divested on a time scale set by CCLA's Investment Committee.

Supporting our clients with their transition

We seek to enable our clients to transition their assets to and from CCLA in the most efficient and cost-effective manner. This means that we often facilitate the in-specie transfer of holdings directly to and from our funds. However, we recognise that clients who are transitioning to CCLA are often moving from managers that have different approaches to aligning client values in portfolio management and are likely to hold assets that do not comply with our funds' policies. Therefore, to facilitate effective transfers CCLA funds can, with the permission of the Investment Committee, hold assets that are out of compliance with any fund's values-based rules for a maximum of 10 working days to enable the efficient on-boarding and restructuring of assets.

Oversight

Whilst every effort is made to ensure that our funds comply with their values-based policies, we recognise that from time to time an asset that does not comply with our policies may be acquired. As such we regularly review our holdings for compliance with each fund and portfolio's values-based policies as follows:

- **Daily review**. In addition to barring transactions, CCLA's order management system identifies any fund holdings that have not been approved or out of compliance with each fund and portfolio's values-based policy on a daily basis.
- **Monthly review**. CCLA's specialist Sustainability team performs a manual review of all holdings to ensure compliance with values-based policies on a monthly basis.
- **Bi-annual review**. CCLA's Investment Committee reviews all investments that have been manually approved on a bi-annual basis.

It is not CCLA's policy to assume any responsibility for the impact of any changes in the underlying value of any security that is bought, sold, or held in a manner that is out of compliance with the fund's values-based rules.

Important information

This document is not a financial promotion and is issued for information purposes only. It does not constitute the provision of financial, investment or other professional advice. To ensure you understand whether our products are suitable, please read the fund fact sheets and the scheme particulars and the risk factors identified therein. We strongly recommend you seek independent professional advice prior to investing.

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