Downing

# Downing LLP

## Responsible Investment: Exclusions And Negative Screening Policy

June 2024

FCA Firm Reference Number: 545025

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# Introduction

Our corporate purpose is to 'Make investment more rewarding'. Our Sustainable Investment purpose is 'Investing for Return. Caring about the World'.

This means being profitable for our investors, supportive to the businesses we fund and ultimately rewarding for society. With 35 years of operating history, Downing is a client focused investment specialist with retail, wholesale and institutional clients. We offer a differentiated portfolio of high conviction products from specialist investment and client teams. Strategies are categorised into listed equity and private markets, with the latter covering energy & infrastructure, property finance & specialist lending, healthcare ventures and development capital. Downing is based in London with ~£1.8bn assets under management. As a partnership, we work for the benefit of our members; as a B Corp, we strive to have a broader positive impact and show regard to all our stakeholders through Sustainable Investment.

**Approval by Governing Body**

Downing LLP's Sustainable Investment: Exclusions Policy 2024 has been reviewed and approved by its duly constituted governing body, the Downing LLP Executive Committee. The Policy is signed below by Tony McGing, Chief Executive Officer of Downing LLP, on behalf of the Executive Committee, and shall be published on the Downing website.

T. McGing

Tony McGing, CEO

Roger Lewis

Roger Lewis, Head of RI

# Policy Overview

The purpose of this Policy is to formally outline the application of exclusionary / negative screening to investment. It forms part of the integration of Sustainable Investment across Downing LLP.

Downing adopts a tier architecture for ESG polices as set out below. This captures both firm-wide principles and asset-level idiosyncrasies. This document is a Tier 2 Policy and its scope applies to all investment teams, all asset classes and all regions. Specific application is then achieved via Tier 3 Policies. These Policies show our position on ESG to stakeholders, guide investment teams on how to handle ESG issues and demonstrates our overall approach, recognising impact to client outcomes.


**Governance of Sustainable Investment and this Policy**

The Head of RI has overall accountability for achieving this Policy's requirements, and other Tier 2 ESG Policies. This accountability is supported by the ESG Committee (see below) and a bi-monthly ESG Investment & Client Working Group. Responsibility for implementation of Tier 3 ESG Policies lies with investment teams. All ESG Policies are reviewed annually and approved by the ESG Committee. Once approved, they are made publicly available on the Downing website.

We commit to quarterly, Exec- / Board-level oversight of sustainable investment. This is achieved via an ESG Committee. Its objective is governance, discussion and discovery for all ESG activities across Downing LLP. This includes decisions, approvals, risks and updates covering: strategy, investment, client, stewardship, reporting & regulation.

At Board level, the COO has accountability for successful integration of material sustainability factors. In addition, each of our investment businesses has a Partner who heads the business and owns both the P&L and the sustainable investment strategy for their business.

# Exclusions in Summary

**Commitments**

Downing LLP will exclude from its investments activities in:

1. Controversial weapons: Companies involved in the manufacture, distribution, maintenance, trade, transport or storage of controversial weapons and deriving income from these activities

2. Adverse climate effects: Investments whose sectors, assets and operations can create excessive climate change impacts and these are not being well managed

See the next section for further detail on these, and our position on other high ESG risk sectors.

This covers all companies worldwide: state owned / private, listed / unlisted. Sanctions and legal restrictions applicable to the jurisdictions where we operate are followed.

This Policy applies to all products and funds managed by Downing LLP, and to any financial instrument. There are two exceptions to this as individual security selection is outside of our direct control:

- Multi-manager strategies and holdings in third party fund managers
- Exposure to a financial index in which the company is a constituent

Where third party data is used to determine the companies' activities in the excluded areas above, including revenue amounts, we have the ability to over-rule this if it is not believed to be an accurate representation of the overall business. If utilising this, evidence for over-ruling the exclusion shall be documented by the investment team and verified by the ESG Committee.

This Policy applies to any new investment from the effective date. Existing holdings, if any, that become excluded will be monitored on a risk watchlist for future action.

In the Downing RI Policy, we recognise the International Corporate Governance Network's Global Stewardship Principles as a resource for global best practice in engagement (Engagement for Real Outcomes, page 6). Principle 3 requires continuous risk monitoring and assessing investee companies as an obligation of fiduciary responsibility. This is a core objective of this Policy, in particular where an ESG risk occurs before or during an investment, and engagement becomes a priority.

The RI team provides expertise and independent oversight to all these processes.

Our rationale for these exclusions follows:

- As a responsible investor, acting with common decency is a core priority of our sustainable investment strategy. We do not wish to be financing these activities with equity or debt
- Downing is proud to be certified as a B Corp and has made a legally binding commitment to show regard to all our stakeholders (staff, customers, communities, the environment and overall governance). We believe these exclusions form an important part of this obligation, alongside our signatory status to the UNPRI and UN Global Compact
- Clients are increasingly demanding or expecting this exclusionary screening
- Regulatory requirements – in certain areas it may be illegal to invest in these activities
- Reputational risk to Downing and our clients of association with these investments

Notwithstanding the two exceptions above, all investment teams commit to this Policy:

**Downing Fund Managers:** Boutique of eight funds that actively invest in listed equities, including global, European, strategic micro-cap, listed infrastructure, unique opportunities, small and mid-cap income and multi manager (balanced and cautious).

**Energy and Infrastructure:** Operating, construction ready and development stage solar, wind, hydro and biomass assets across multiple geographies. Also battery storage investments, to complement the intermittency of renewables.

**Development Capital:** Asset-backed companies enabling investees to realise their growth plans by providing flexible solutions for their capital needs. This includes: Data Centres, Education, Residential Care Homes, Hotels, Property Development, Pubs, Specialist Education and Specialist Living. This includes partnering with management teams whose ethos, beliefs and interests are aligned to ours, including for environmental and societal outcomes.

**Specialist Lending:** Loans to residential property developers in the UK, typically smaller sized borrowers and developments, and wholesale lending.

# Exclusions in Detail

**Types of Exclusion – ESG is 'grey'**

We use the concept of hard and soft exclusions. This is in order to recognise that there is upside – investment and environment, societal or governing – to be captured from certain assets that may have issues today but are improving, or enabling wider positive change within their sectors or locations.

No Downing capital shall be invested in a *hard* exclusion.

For *soft* exclusions: Enhanced ESG due diligence shall be performed for any investment in these sectors. This will include plans for monitoring the risk with a watchlist across all Assets Under Management, with rationale for holding, expectations, targets and progress against these. The approach centres around engagement, both internal (detail will be frequently reviewed by the ESG team and ESG Committee) and external with the investee. This is based on the concept of soft law and expectations to 'comply or explain'.

**Category 1. Controversial Weapons: Hard Exclusion**

Companies involved in the manufacture, distribution, maintenance, trade, transport or storage of the controversial weapons as specified below and deriving income from these activities. The applicable treaties and conventions that Downing hereby agrees to comply with are also specified. Any new treaties regarding controversial weapons agreed by international law will be considered for future updates of this Policy.

- Cluster Munitions (a munition that is designed to disperse or release explosive submunitions). *The UN Convention on Cluster Munitions (Oslo, 2008)*
- Landmines (mines designed to be exploded by the presence, proximity or contact of a person and which will incapacitate, injure or kill one or more persons). *The Anti-Personnel Landmines Treaty (Ottawa, 1997)*
- Biological & Chemical Weapons (use pathogens: viruses, bacteria, disease-causing biological agents, toxins; or use chemical substances). *The Biological Weapons Convention (1975) and The Chemical Weapons Convention (1977)*
- Weapons that breach rules for the protection of civilians from injury under the *UN Convention on Certain Conventional Weapons* (*Geneva, 1980*):
    - Non-detectable (by x-ray) Fragments
    - Mines, Booby-Traps and Other Devices
    - Incendiary weapons. For clarification, these are designed to set fire to objects or to cause burn injury to persons through the action of flame, heat or a combination thereof, produced by a chemical reaction of a substance delivered on the target
    - Blinding Laser Weapons
- Depleted Uranium

**Category 2. Adverse Climate Effects: Hard (revenue) or Soft (activity) Exclusion**

Companies whose operations create excessive climate change impacts and are excluded are specified as any with greater than 30% revenue from the following activities:

- Mining that extracts thermal coal (no tonnage number for coal extracted is applied at present, and shall be considered for future versions of this Policy)
- Mining that develops significant new thermal coal assets
- Mining that extracts other non-renewable energy sources with high greenhouse gas impacts: oil and tar sands
- Power generation with electricity generated by coal and no credible plans to move to renewable or low carbon alternatives
- Power generation that plans to expand coal power generation capacity
- Production of heat or energy from fossil fuels, including oil and gas. This excludes infrastructure investments where gas is used as a transition fuel (such as gas peakers) in order to enable wider decarbonisation, as is also recognised within the EU Taxonomy for sustainable activities

Given energy & commodity price volatility, revenue is based on three-year averages using contract instead of spot prices where possible. We recognise that an assessment based on current year revenues only could lead to the wrong conclusion given volatility in market prices.

The following activities are not excluded under this Policy:

- Mining that extracts metallurgical (“met”) coal, used in steel making
- Physical coal plant facilities as real assets, acquired by Downing Energy & Infrastructure for the purpose of converting to green / renewable energy generation, including biomass

However, for revenue in these sectors of less than 30%, a soft exclusion can be applied at the fund manager’s discretion. This is important to explain. Certain companies or sectors are hard-to-abate, or their near-term harmful impacts enable greater long-term benefits. For example:

- Coal use enabling economic growth in developing countries (S benefit as more middle class are created), who then de-carbonise their power and industry (E and climate benefit), with targets and transparent reporting on both objectives; or
- Public companies selling fossil fuel assets to national companies, where emissions are likely to continue with less transparency is ultimately a negative environmental outcome and investor voice may be more appropriate

We recognise that a soft exclusion in these instances is a subjective view and can lead to investments with fossil fuel revenue. If applying, we commit to following the approach to soft exclusions.

**Category 3. High ESG Risk Sectors and Global Standards: Soft Exclusion**

Downing does not have any exclusionary funds or strategies. Similarly, we do not make moral judgments on certain sectors as this can cause confusion for clients, and due to a rapidly changing world & geopolitics, no-go areas today can become important tomorrow. Instead, as with financial reporting, we advocate clarity and transparency as a key way to deploy capital and provide oversight on our investments.

The 'sin' sectors below (note this is not a comprehensive list) are not excluded as they have a licence from society to operate.

*Alcoholic Beverages, Adult Entertainment, Animal Testing Pharmaceutical products, Cannabis, Gambling, Pesticides, Predatory Lending, Shale Energy, Small Arms, Tobacco Products*

Given the nature of these sectors, we commit to following the approach to soft exclusions. This is in order to mitigate the risks to return, ESG and their social licence through active ownership. Especially important is the company's activity and management of potential sector ESG risk. If they are encouraging addiction or covering harmful effects of their product, identified via a controversy or other adverse media, then enhanced risk monitoring and engagement and escalation is applied. As with all sectors, we advocate appropriate regulation and paying of taxes; given the nature of sin sectors, companies' responses to regulation and taxation may also be monitored.

Another high ESG risk occurs for investees that fail or are on a watchlist for behavioural norms. This is defined as verified, sustained (beyond allegation) breaches of the ten principles of the UN Global Compact and related global standards:

*Human Rights*
*Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights;*
*Principle 2: make sure that they are not complicit in human rights abuses.*

*Labour*
*Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;*
*Principle 4: the elimination of all forms of forced and compulsory labour;*
*Principle 5: the effective abolition of child labour;*
*Principle 6: the elimination of discrimination in respect of employment and occupation.*

*Environment*
*Principle 7: Businesses should support a precautionary approach to environmental challenges;*
*Principle 8: undertake initiatives to promote greater environmental responsibility;*
*Principle 9: encourage the development and diffusion of environmentally friendly technologies.*

*Anti-Corruption*
*Principle 10: Businesses should work against corruption in all its forms, including extortion & bribery.*

**Application of this Policy in Practice**

Exclusions will be informed and made possible by external data created by third party providers and our own internal research and analysis.

For certain DFM investments, exposure to these sectors is dependent on screening from external data providers in order to inform our response. For DFM investments not covered and for Private Markets, our own ESG analysis incorporates sector and global standards factors in order to determine the risk of an investee breaching these.

For DFM specifically, the following are used:

- Product Involvement Screening Research data from Sustainalytics
- The Global Coal Exit List (a source of coal data, published by Urgewald: www.coalexit.org) and resources from the Powering Past Coal Alliance (www.poweringpastcoal.org)

Fund Managers apply this Policy into investment decisions. Pre-trade compliance checks are used for the hard exclusions (DFM only).

For Multi Manager funds, where we identify buy-rated funds with exposure to controversial weapons, coal or other ESG risk, we commit to engaging with the managers to understand their rationale for holding and possible future options. This shall be during periodic due diligence reviews, or as needed. Divestment and withdrawing a buy-rated shall be considered as well in extreme cases where the risk is not being effectively mitigated in our opinion.

For Private Markets, given the nature of assets and companies invested in, third party data is not applicable. Instead, as part of the investment evaluation, teams shall review the sectors of investments against this Policy. This is done using a proprietary scorecard and ahead of Investment Committees.