

# RATHBONES

Established 1742

## RATHBONE ETHICAL BOND FUND

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ETHICAL PROCESSES AND SYSTEMS

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# ETHICAL PROCESSES AND SYSTEMS

## Who are Rathbone Greenbank Investments?

The ethical research for the fund is carried out by Rathbone Greenbank Investments, the award-winning specialist ethical investment unit of Rathbone Investment Management Limited (part of Rathbone Brothers Plc). The team at Rathbone Greenbank has been at the forefront of developments in the ethical investment industry since 1992, launching one of the first bespoke ethical portfolio services.

Since 1997, when the team joined Rathbones, Rathbone Investment Management has offered a dedicated responsible investment service.

In 2004, this unit was formally rebranded as Rathbone Greenbank Investments and now works with over 800 clients, managing in excess of £458 million.

Rathbone Brothers Plc is a member of the FTSE4Good Index Series – Rathbones is a signatory to, and participant in, the Carbon Disclosure Project, as well as being a signatory to the UN Principles for Responsible Investment.

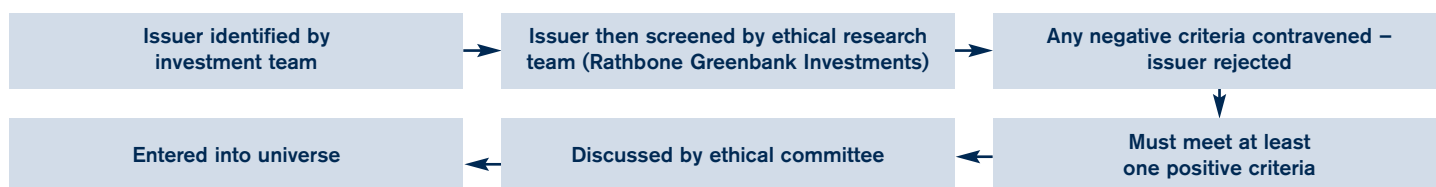
## How does Rathbone Unit Trust Management work with Rathbone Greenbank?

To ensure the suitability of the investments in the fund, we have access to a dedicated ethical research team. Rathbone Greenbank's ethical research team works in conjunction with the manager of the fund to ensure that investments are only made in bonds issued by approved organisations. They are responsible for the daily monitoring of company news on environmental and social matters. As companies change their activities, merge with others, or develop new policies and practices, their suitability and risks will alter.

The team also conducts special research and engagement projects on key issues. You can find out more at [www.rathbonegreenbank.com](http://www.rathbonegreenbank.com)

## Our process – overview

1. The fund manager will first identify corporate bonds that represent an attractive investment proposition.
2. Companies issuing these bonds will then be investigated by Rathbone Greenbank's ethical researchers, based in Bristol.
3. Issuing companies involved in any activities that fall into the categories outlined by negative criteria will not be considered for inclusion in the fund universe.
4. Issuing companies demonstrating well-developed policies and practices in at least one of the positive areas will be included in the fund universe, provided they are not involved in any areas of negative concern.
5. Companies identified as being suitable at this stage will then be subject to the consensus approval of at least two senior members of the Rathbone Greenbank team.
6. An annual review meeting for the Rathbone Ethical Bond Fund will be held involving the researchers, the fund managers and representatives from Rathbone Greenbank Investments and Rathbone Unit Trust Management. This meeting takes place before the Annual Short Report is issued. The portfolio, criteria, investment process and research process are all reviewed. The criteria and portfolio content will be confirmed (or not).
7. The Annual Short Report of the fund will contain summary details of the portfolio (a full listing is available in the Long Report, available on request from the Manager) and an ethical report. This will include details of any proposed amendments to ethical criteria or to the screening process. Comments and feedback on any aspect of the fund are welcomed.
8. If any proposed changes attract significant comment, there is an ad-hoc meeting to review comments and determine action. Any changes are confirmed in the interim report (if appropriate).



## Compliance with the European SRI Transparency Guidelines

Rathbone Unit Trust Management (RUTM) is committed to transparency and we believe that we are as transparent as possible given the regulatory and competitive environments that exist in the countries in which we operate. RUTM believes that it meets the recommendations of the European SRI Transparency Guidelines excepting questions which we do not feel are appropriate for a fund of the type in question. Selected responses to the Guidelines are given below. Our full response to the European SRI Transparency Guidelines is accessible on RUTM's website at [www.rutm.com](http://www.rutm.com)

## COMMUNICATIONS

Fund manager names and contact details can be found in our supporting literature, available on request and on our website [www.rutm.com](http://www.rutm.com). Fund factsheets (including fund sizes) and quarterly investment reports detailing the fund's performance history can be found at our website under the 'Our Funds' section.

### How do we communicate with investors?

- **Monthly:** The Rathbone Ethical Bond Fund factsheet summarises fund performance for the period, sector asset allocation, ten largest holdings and credit quality and maturity distribution.
- **Bi-annual:** The Rathbone Ethical Bond Fund manager report (April & October). Both short and long versions of interim and annual reports are published alternately every six months. Contents include a manager's report; an ethical report (long version); a full list of holdings (long version) and the ten largest holdings (short version).

An archive of all reports is available at [www.rutm.com](http://www.rutm.com) and/or by calling 020 7399 0399.

### What are our corporate responsibility policies?

Rathbones has implemented corporate responsibility policies relating to the Group's environmental impacts, employee welfare & benefits and community involvement. Progress is reported annually in the Group's report and accounts and via the 'Investor Relations' part of the website [www.rathbones.com](http://www.rathbones.com)

## SRI INVESTMENT CRITERIA

### How do we define SRI for the fund?

In general terms, for the fund, we define socially responsible investment as an investment strategy in which we believe long-term growth can be achieved by companies which conduct their business and apply capital responsibly, giving full consideration to a range of social, environmental and ethical issues as they might affect concerned parties (employees, customers, shareholders, etc.) as well as wider society.

Specifically, the fund applies key negative exclusion criteria to issuers of corporate bonds before ensuring that any issuers not in breach of these satisfy at least one of the fund's positive activity requirements.

### What are the SRI investment criteria of the fund?

The fund's SRI criteria are defined in a separate investment criteria leaflet, available at:

[www.rutm.com/ia/fund-rathbone-ethical-bond-fund.aspx](http://www.rutm.com/ia/fund-rathbone-ethical-bond-fund.aspx)

### How are the SRI criteria defined, and how frequently and by whom are the criteria reviewed?

Criteria are defined with reference to the fund's ethical committee which meets once a year as part of the fund's annual review process. Changes to criteria are expected to be infrequent: none have occurred since the fund's launch in 2002. Any proposed changes would be published in the subsequent annual report.

### How are criteria changes communicated to investors?

Any changes to the fund's ethical criteria will be communicated through the annual report.

## RESEARCH PROCESS

### What is the SRI research methodology and process?

The application of the fund's ethical investment criteria is carried out by Rathbone Greenbank's ethical research team, which maintains a database of company profiles covering mainly FTSE 350 equities, but also including selected overseas stocks. Companies are assessed against some 35 positive and negative top-level social and environmental criteria, comprising a further 150 distinct sub-criteria.

To achieve consistency of rating, companies are assessed on both a bottom-up (looking in detail at the specific merits of their individual activities and how they address corporate responsibility issues) and a top-down approach (evaluating this performance in comparison to their peers in terms of the range of corporate responsibility issues covered and quality of response).

In addition to the reporting outputs of companies themselves, the ethical research team accesses a variety of sources (industry groups, Non-Governmental Organisations (NGO's), sell-side analysts, external research bodies) to arrive at a balanced view of companies' overall performance.

Research is also conducted on a thematic basis and has examined such topics as: climate change, clean energy, human rights, community investment and employee welfare.

Given the significant overlap between constituents of this database and the fund's investable universe (defined as the constituents of the iBoxx index of Sterling-denominated corporate bonds), this research is applicable in the context of the fund's ethical criteria as well.

Where bond issuers are not covered by the equity research, separate investigation is carried out in the same way to determine whether it is appropriate for issuers to be approved for inclusion in the fund's universe.

### Do we use an in-house research team and/or an external research team?

The fund manager uses Rathbone Greenbank's in-house research team comprising three full-time staff. The team does not use an external research service, but has access to research provided by sell-side SRI analysts.

### Is there an external control or external verification process in place for the research process?

The fund does not have an external committee or verification process; it believes this control is provided by accountability to investors and public scrutiny. The complete portfolio is published in the annual report (long version). Unitholders and others are encouraged to comment on the fund's holdings and how they view the application of its ethical criteria.

The research process does not include stakeholder consultation or the option for companies to review analysis on them. The research process is reviewed annually at a formal meeting.

### What research findings are disclosed to the public?

The ten largest holdings are disclosed monthly and a full list of holdings is published in the long version of the fund's annual report. A limited number of brief "case studies" for selected holdings are published as part of the fund's literature.

## EVALUATION AND IMPLEMENTATION

### What internal or external measures are in place to ensure portfolio holdings comply with SRI investment criteria?

At the time of investment, the fund manager is required to have clear approval from the ethical committee. This is complemented by a review of all holdings at the annual review meeting. The portfolio is open to public scrutiny: comments and questions are invited on any of the holdings in the portfolio.

### What is the policy and procedure for divestments on SRI grounds?

Divestments are very uncommon. If the activities of an issuer change, so that a bond is no longer suitable for the fund, the fund manager would normally seek to sell the holding within three months. If the bond is particularly illiquid and selling is difficult, the manager can take up to six months. If the bond is within two years of redemption, it can be held to maturity if the fund manager believes selling it earlier would be prejudicial to the overall performance of the fund.

### Are investors informed about divestments on SRI grounds (if so, how often and by what means)?

Any divestments, or proposed divestments, made on SRI grounds, would be mentioned in the ethical report section of the annual report.

We do not inform companies of portfolio exclusions or divestments due to non-compliance with its SRI policy and criteria.

## ENGAGEMENT APPROACH

### What is our approach to engagement for this fund?

As the fund is a corporate bond fund and voting rights do not usually attach to its underlying holdings, the fund itself does not have a formal engagement policy as part of its strategy. However the ethical research team of Rathbone Greenbank, which provides ethical screening services for the fund, regularly engages with companies on a variety of issues.

Whilst this activity is primarily undertaken on behalf of Rathbone Greenbank's private clients, where corporate bond holdings in the fund overlap with Rathbone Greenbank's equity holdings, the team will engage with companies on behalf of all concerned parties.

### What are the aims of the engagement policy?

Engagement forms a key part of Rathbone Greenbank's approach to responsible investment. It is used in the following ways:

- To address direct concerns about a specific company issue or area of performance;
- To encourage best practice, providing internal momentum for positive change within companies;
- In the context of a 'best of sector' investment strategy, to encourage companies within controversial or high environmental impact sectors (e.g. oil & gas, pharmaceuticals) towards more positive behaviour or better disclosure.

Engagement will be guided by the following principles:

- Rathbone Greenbank will seek open and constructive dialogue in a spirit of long-term partnership;
- Engagement will be made on the basis of corroborated evidence or research which is of a rigorous and independent nature.

### How does the fund prioritise with which companies it will engage?

Rathbone Greenbank favours engagement on those issues where it has particular expertise, or where positive outcomes are clearly identifiable, in order to make most effective use of time and resources.

### What methods of engagement are employed?

- Formal and informal correspondence and/or meetings with company representatives;
- Where appropriate, Rathbone Greenbank will seek to collaborate with other members of the SRI community as well as other fund managers within Rathbone Investment Management. When doing so, the principles stated above will guide the level of involvement and choice of partners.

### How is the effectiveness of engagement activity monitored/addressed?

In measuring the effectiveness of its engagement strategy, Rathbone Greenbank will:

- Consider any material changes in company policy or performance achieved from year to year, (in the course of the ethical research team's regular updating of company profiles);
- Aim to report at least once a year to clients the scope and number of engagement activities undertaken.

### How, and how frequently, are engagement activities communicated to investors and other stakeholders?

Any engagement activity undertaken specifically with regard to holdings in the fund will be communicated through the annual report.

# INVESTMENT CRITERIA

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## Exclusions

The fund shall exclude bonds issued by companies wholly or predominately involved in the following activities or whose ultimate holding company is similarly involved:

- **Alcohol**  
Companies involved in the production of alcoholic beverages.
- **Animal testing**  
Companies providing animal testing facilities, or those which use animals in the discovery or development of pharmaceutical or healthcare products; manufacturers or retailers not adopting a fixed cut-off date policy with regard to the testing of cosmetic or household products (and their ingredients) on animals.
- **Armaments**  
Manufacturers or vendors of strategic weapon systems, ordnance or combat vehicles.
- **Environmentally unsustainable or high-impact activities**  
Companies involved in mineral extraction, fossil fuel exploration and production, quarrying, agrochemical production, production of genetically modified seeds or foodstuffs; sale of hardwood products from unsustainable sources; motor car manufacturing, or road building. Also, companies with convictions for serious or persistent pollution offences.
- **Gambling**  
Companies operating betting or gaming facilities (including casinos, betting shops and internet-based services).
- **Nuclear power**  
Companies involved in the construction of nuclear power plants, the generation of electricity from nuclear power, or the handling or reprocessing of radioactive waste.
- **Pornography**  
Companies involved in the production or sale of pornographic material.
- **Tobacco**  
Manufacturers of tobacco or tobacco products.

## Positive aspects

To qualify for inclusion in the fund's universe, companies issuing bonds should demonstrate progressive or well-developed practice or policies in one of the following key areas:

- **Corporate community investment**  
Companies should demonstrate long-term involvement in programmes of benefit to the community, either via cash donations or gifts in kind (e.g. staff time, use of buildings or office facilities) or membership of corporate donation benchmarking groups such as Business in the Community's PerCent Club or the London Benchmarking Group.
- **Employment**  
Companies should demonstrate a commitment to workplace diversity and equal opportunities; additionally they could facilitate employee work/life balance by offering flexible working arrangements, carers' leave and/or childcare facilities.
- **Human rights**  
Companies should comply with local and national standards in accordance with minimums set by the International Labour Organisation and United Nations Universal Declaration of Human Rights. Alternatively, companies may implement their own codes of conduct to ensure compliance with local laws covering child labour, working conditions and health and safety.
- **Management of environmental impacts**  
Companies should have a clearly defined and published policy for managing their environmental impact. This should include monitoring and reporting on progress against key performance indicators in areas such as waste disposal and recycling, consumption of resources, emissions to air, and discharges to land and water.
- **Provision of beneficial products and services**  
Companies should be involved in providing products or services that offer social or environmental benefits. Such activities might include designing or implementing cleaner or more efficient industrial processes; companies involved in enabling compliance with health and safety legislation; supplying educational products or services; providing waste recycling or acceptable forms of waste management (excluding energy-from-waste incineration); providing social housing; manufacturing, installing or operating renewable energy infrastructure; building or operating sustainable transport systems.

### Important note

You should be aware that the criteria on this page may be subject to change.

# INVESTMENT STRATEGY

## 1. Macroeconomics – Interest rate risk

The major risk a bond fund will face is a change in monetary policy and thus interest rates. Any change of interest rates has an inverse impact on the price of a bond. The sensitivity of a particular bond to changes in interest rates is known as its *modified duration*.

If the manager expects a general rise in interest rates, it is likely he will structure the portfolio so that the average modified duration is less than that of the FTSE Actuaries All-Stocks Gilt index. In this way, the manager will hope to limit any fall in prices. The manager may also invest a proportion of the fund in *floating rate securities*. These instruments have a rate of interest which changes with base rates.

If interest rates are expected to fall, then the manager may structure the portfolio with an average modified duration that is more than that of FTSE Actuaries All-Stocks Gilt index. The manager believes this should lead to an out-performance in terms of price during falling interest rates.

## 2. Asset allocation

The overall credit quality of the fund will be the weighted average of the credit rating of each security within the fund. The manager will choose a portfolio that will reduce the overall credit risk of the fund during periods when the economy is expected to contract. During these times, it is likely that individual issuers will face downgrades to their credit rating to reflect the deteriorating trading environment in which they are operating. When the manager expects the economy to be expanding, he will seek, through the selection of securities, to optimise the potential of credit upgrades.

## 3. Selection of individual securities

Decisions are made using a top-down meets bottom-up approach. In-depth analysis of the current macro environment provides a view on the likely direction of future economic growth, inflation, and interest rates. This helps the selection of the overall *maturity, duration and credit quality* of the fund.

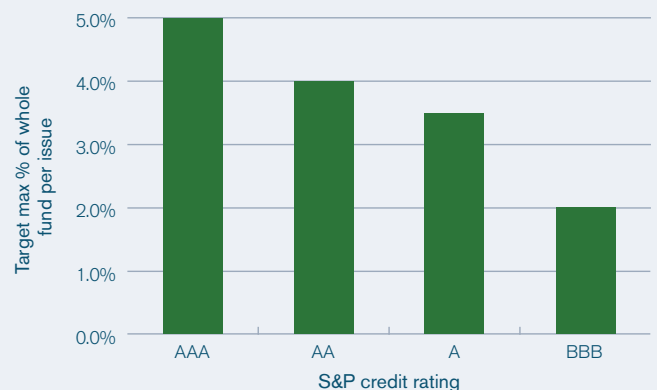
We then examine each individual issuer using the four C's approach to credit analysis.

- **Character:** An assessment is made of a company's management quality and their ability to meet their own and the market's expectations. The extra policing provided by the ethical research team in Bristol is particularly useful here. **Reputational risk at the management level is currently very high.**
- **Capacity:** The ability of an issuer to repay its debts. In-depth analysis of the cashflow in a business is key to this part of the overall approach.
- **Collateral:** The quality of the assets of any company is of paramount importance. Tangible assets can always be sold, whereas in-tangibles cannot. 'Real' assets are good sources of cashflow during good and bad times.
- **Covenants:** These are the terms and conditions detailed in the bond prospectus that govern the way the management may operate the business. At times, they can restrict managements' options. A covenant default can often be the first warning sign of impending trouble. Covenants play an important role in minimising investor risk when lending to corporates.

Depending on credit quality (indicated by the rating), there are limits for each individual issuer in terms of the size of the holding as a percentage of the whole fund.

### S&P credit rating definitions:

- AAA = Issuer has an extremely strong capacity to meet its financial commitments.
- AA = Issuer has a very strong capacity to meet its financial commitments.
- A = Issuer has a strong capacity to meet its financial commitments.
- BBB = Issuer has adequate capacity to meet its financial commitments.





The European SRI Transparency logo signifies that Rathbone Unit Trust Management Limited commits to provide accurate, adequate and timely information to enable stakeholders, in particular consumers, to understand the Socially Responsible Investment (SRI) policies and practices relating to the fund. Detailed information about the European SRI Transparency Guidelines can be found on [www.eurosif.org](http://www.eurosif.org), and information of the SRI policies and practices of the Rathbone Ethical Bond Fund can be found at: [www.rutm.com](http://www.rutm.com). The Transparency Guidelines are managed by Eurosif, an independent organisation.

The European SRI Transparency Logo reflects the fund manager's commitment as detailed above and should not be taken as an endorsement of any particular company, organisation or individual.



the sustainable investment  
and finance association

For more information on ethical investment please visit the UK Sustainable Investment & Finance (UKSIF) website at [www.uksif.org](http://www.uksif.org) Rathbone Greenbank Investments is a member of UKSIF.

**The information contained in this literature is for use by investment advisers only and must not be circulated to private clients or to the general public. We recommend that if you are not an investment adviser, you should consult one before taking further action.**

Rathbone Greenbank Investments is a trading name of Rathbone Investment Management Limited, which is authorised and regulated by the Financial Services Authority.

Rathbones will be relocating its London head office on 27 February 2012 to 1 Curzon Street, London W1J 5FB  
Telephone and facsimile numbers will remain the same. Until then we will remain at our current premises (New Bond Street).

## Rathbone Unit Trust Management Limited

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