EDENTREE RI EXPERT BRIEFING | JULY 2019

GILTS

We are often asked by clients for our views on Gilts and how these comply with our ethical and ESG screening process. In this RI Expert Brief we take a look at Gilts as an asset class and present our House view.

WHAT ARE GILTS?

'Gilts' is a generic term that refers to Bonds issued by the UK Government. They are generally viewed as a low-risk, secure asset class with often long maturity times. Issued by HM Treasury, Gilts or 'Gilt Edged Securities' (originally the certificates were 'gilt-edged') are listed on the London Stock Exchange and come in two forms: Conventional and Index-linked.

Conventional Gilts are the simplest type of Government or Treasury debt and form 75% of the 'book'. A Conventional Gilt guarantees to pay the holder a fixed-income payment every six months (the coupon) until the Gilt matures. These types of Gilt are denoted by the coupon and maturity e.g. 1½% Treasury Gilt 2047. HM Government now tends to concentrate maturity dates around a 5, 10 or 30 year maturity timeframe.

Index-linked Gilts form the remaining 25% of Treasury debt and date from 1981. These Gilts have similar characteristics as Conventional Gilts, except they reflect actual rather than nominal borrowing rates, thus the coupon is variable in line with RPI Index fluctuations.

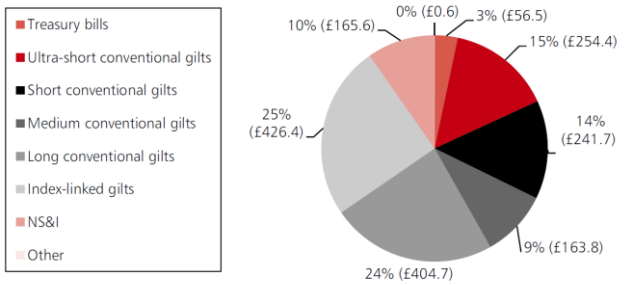
Other types of Gilt have historically included floating-rate, double-dated conventional, and undated, however these types have now been largely withdrawn.

The UK Government became the first country outside of the Islamic world to issue Sharia compliant Sovereign debt in 2014. The Bond of £200m matures in July this year, and HMG has said it will consider the case for a further issue.

HOW MUCH IS CURRENTLY ISSUED IN GOVERNMENT GILTS?

The UK's stock of Index-linked Gilts stood at £426bn at the end of 2018, making up 26% of the total debt portfolio. This has edged up slightly on the historic average of 25% as stated above. The total Gilt portfolio at the end of 2018 was £1,491bn and does not include other forms of debt such as Treasury Bills and National Savings & Investments (NS&I). Total Sovereign debt was £1,547.5bn[1].

Chart A.1 Composition of central government sterling debt in % and £ billion (end-December 2018)[1]



Source: HM Treasury Debt Management Report 2019-20

WHAT ARE THE ETHICAL CONCERNS?

We view Gilts to be ethically acceptable; however, we are very aware that for some clients their place in an ethically screened Fund is questionable. Responsible investors have by and large struggled to integrate ESG (environment, social and governance) screens given one is dealing with Sovereign entities rather than investible companies. We integrate our screening process for corporate fixed-interest instruments via our Oppressive Regimes ethical screen, and we apply the same process to Sovereign and supra-national issuing bodies, where we avoid investing if the territory in question is deemed 'oppressive' as judged by our proprietary screen – we intend to publish an updated RI Expert Brief setting out our thinking on how the Oppressive Regimes screen is applied.

For some clients, the potential allocation of Gilt proceeds to areas of national expenditure such as defence or the nuclear programme make them 'challenging' investments.

There is a case under very strict criteria for avoiding Gilts on the basis that there *may be* some allocation to defence (although we cannot know this for sure). We do not draw this conclusion from an investment perspective as we support the

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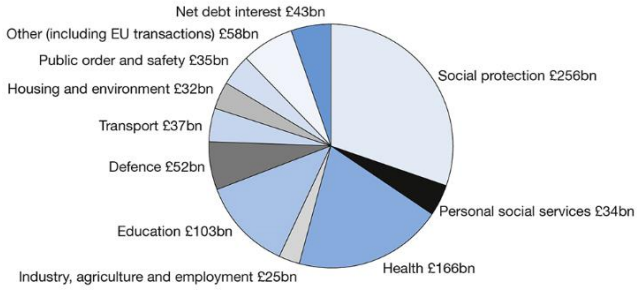
democratic process in which a political party (and subsequent Government) sets out its spending plans within a Manifesto for office. In a democracy such as the UK, taxation receipts and other public funding provision is not hypothecated; we cannot choose to have taxes allocated to areas of public spending we prefer. One of the Government's duties is to protect its citizens and all contribute to national self-defence via public funding in the same way as all contribute to funding the NHS or State pensions.

Chart 1: Public sector spending 2019-20



Source: HM Treasury Debt Management Report 2019-20

In the 2018 Budget Statement, the UK Government set out its total spending plans to be around £842bn in 2019/20[2]. Of that, social protection, social services, health and education account for 66% - two-thirds – of Government spending. Defence represents £52bn or 6% of national spending[3]. This would fall comfortably below our 'screened threshold' of 10% were we to apply a screen.

HAS THE UK GOVERNMENT ISSUED GREEN GILTS?

The UK Government has not issued any 'green bonds' to date, although we would be attracted by the possibility. There is a precedent with the Republic of Ireland issuing a €3bn Bond in 2018[4]. This aligns with the Green Bond Principles, where the proceeds will be used to finance eligible 'green' projects such as water and waste management, clean transportation, land use, and climate change related investment. The Bond issuance supports the Irish Government's National Development Plan to spend 13% of Gross National Income (GNI) up to 2027 on green infrastructure[5].

In the UK there have been quasi-state issuances such as the TFL (Transport for London) 10 year Green Bond in 2015, with the proceeds used to enhance public transportation on the TFL network e.g. hybrid buses and cycling improvements.

WHAT IS EDENTREE'S POSITION?

We believe Gilts have a place in a balanced portfolio of fixed interest instruments where they provide surety of capital preservation and enhance fund liquidity over the medium to long-term. We are cognisant that for some clients Gilts may be less acceptable given the potential for the proceeds being allocated to defence. However as a House we define Gilts as 'ethically acceptable' as an asset class. Save for public-policy advocacy, we do not, as investors, have the same leverage to engage as we would routinely do with corporates. Moreover, we view the democratic process itself as sufficient for determining how best Government should allocate scarce financial resources. Investment exposure is fairly modest with UK Treasury Gilts held in only the Amity Sterling Bond Fund.

[1] HM Treasury Debt Management Report 2019-20
[2] HM Treasury Budget 2018 Policy Paper
[3] Ibid
[4] NTMA Irish Sovereign Green Bonds October 2018
[5] Ibid

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We have a specialist in-house Responsible Investment (RI) team who carry out thematic and stock-specific research to identify ethically responsible investment ideas for our range of Amity funds. Headed up by Neville White, Head of RI Policy & Research, and supported by Responsible Investment Analysts Esmé van Herwijnen and Jon Mowll, the team is also responsible for creating an on-going dialogue with companies, allowing us to engage on a wide variety of ethical and socially responsible investment concerns. Our ethical and responsible investment process is overseen by an independent Amity Panel that meets three times a year, and comprises industry and business experts, appointed for their specialist knowledge.

We hope you enjoy this RI Expert Briefing and find it useful and informative. For any further information please contact us on 0800 011 3821 or at ifa@edentreeim.com