

# Ethical Investments

**Ethical investing is about choosing to do more with your investment than just look for a good return on your money. There's no ethical investment sector in funds, although there is an ethical stock market index - FTSE4Good. What is ethical and what is not are often different things to different people.**

Put simply, ethical investment seeks to invest in companies which make a positive contribution to the world and seeks to avoid companies which harm the world, its people or its wildlife. It is difficult for an individual investor to judge whether a particular company is ethical or not. Therefore, most ethical investments are held through a managed investment fund such as a unit trust or life insurance or pension fund.

There are funds which merely exclude investment in specific activities or industries such as tobacco, gambling, alcohol and armaments. Others take a more pro-active stance, actively looking to invest in companies involved in environmentally sound, socially progressive businesses.

A third way, which evolved in the late 1990s, goes further. It is based on the belief that ethical or socially responsible investment should go beyond the 'avoidance' or 'supporting' approaches described above. Often called an 'engagement' or 'influencing' approach, here the investment fund will not apply any screening criteria to its investment choices. Instead, the fund manager undertakes to create a dialogue with a certain number of companies in the portfolio on a specific number of social and environmental issues. The aim is to encourage them to adopt the best business practices. Those companies which are already demonstrating a good performance in this area, are encouraged to continue to set the highest standards.

Although there is no defined ethical sector, the Association of Investment Companies does have an 'environmental' sector classification for investment trusts.

Since the launch of the UK's first range of ethical investments by Friends Provident under the Stewardship banner in 1984, other financial institutions have entered the market, and there are now more than 80 different ethical and socially responsible funds to choose from.

## Ethical investment criteria

Some funds adopt an engagement approach which 'overlays' the fund and does not affect investment decisions in any way. The only criteria for inclusion or exclusion are geographical and financial. Beyond that, the investment management group uses its power as a

shareholder to encourage companies to adopt best business practices. However, most UK ethical funds are not engagement funds and are based on a combination of positive and negative investment criteria. Some emphasise the former, while others concentrate on the latter, and some try to strike a balance between the two.



For example, Friends' Provident's Stewardship fund seeks to invest in companies which, it believes, make a positive contribution to society, and avoid those which harm the world or its people. Some 'harmful' activities are regarded so seriously that Stewardship will not invest in such a company under any circumstances, such as arms manufacture. In other cases, harmful behaviour may be counterbalanced by exceptional performance on the positive side of the equation. These marginal cases are scrutinized closely and reviewed more frequently than those which are clear cut. The Stewardship fund uses both positive and negative criteria to decide whether a company is a suitable investment, other funds have their own set of criteria.

To identify companies which make a positive contribution to society, Stewardship focuses on their record in the following areas:

- Supplying the basic necessities of life
- Providing high quality products and services which are of long term benefit to the community
- Conservation of energy or natural resources
- Environmental improvements and pollution control
- Good relations with customers and suppliers
- Good employment practices
- Training and education
- Strong community involvement
- A good equal opportunities record
- Openness about company activities

In identifying activities which harm the world or its inhabitants, Stewardship prefers to avoid the following areas:

- Environmental damage and pollution
- Unnecessary exploitation of animals
- Trade with or operations in oppressive regimes
- Exploitation of Third World countries
- Manufacture and sale of weapons
- Nuclear power
- Tobacco or alcohol production
- Gambling
- Pornography
- Offensive or misleading advertising

Most ethical funds managers use external consultants such as EIRIS, the independent Ethical Investment Research Services - [www.eiris.org](http://www.eiris.org). EIRIS was originally set up in 1983 with the help of churches and charities which had investments and needed a research organisation to help them put their principles into practice.

In fact, the "ethical/environmental" tag may be on the way out. Such funds in the USA prefer to use the term "socially responsible investing" or SRI. This attempts to take a positive approach to investing rather than a negative one which rules companies out. SRI wants to

encourage better business practices. Thus where an ethical fund might not invest at all in a given industry sector, a fund run on SRI lines would invest in the company which is making the best effort to improve its environmental policies. SRI fund managers also indulge in what they call "constructive dialogue", talking with managements on a continual basis to encourage better practices.

## Making the ethical choice

Most ethical trusts and funds have a bias towards smaller and medium sized companies. This is because most of the very large companies, due to their history and diverse range of activities, tend to fail the screening criteria. Ethical fund managers tend to know a great deal more about the companies they invest in than ordinary fund managers. The ethical screening process requires ethical managers to ask more questions to identify investment opportunities.

Ethical investments are often referred to by their shade of 'green'. Light green funds will generally be prepared to invest in the oil industry, pharmaceutical companies and banks, but will shun arms companies, tobacco conglomerates and research companies engaged in testing on animals. Dark green funds adopt much stricter ethical criteria and will exclude any companies that fail to meet their required standards.

Light green funds are less concerned with avoiding investments, using a positive 'best of sector' approach to portfolio selection to invest in the top 200 UK companies and similar sized ones in Europe and North America. Dark green funds inevitably exclude a large proportion of leading companies from their potential portfolio - and therefore a significant proportion of the stock market.

You may invest in a variety of unit trusts and open-ended investment companies, through life assurance funds to pension funds that rely on ethical investment criteria.

There are also ethical Individual Savings Accounts (ISAs) regular savings plans, investment trusts, investment bonds - even ethical mortgages for those wanting to borrow and, of course, not forgetting ethical credit cards made from biodegradable plastic!