

Sustainable and responsible investing

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What is sustainable and responsible investing?

Sustainable and responsible investing looks at the wider impact of investing on society and the environment when seeking financial returns. It takes into account social or environmental criteria in addition to financial criteria. It is a different way of looking at any investment opportunity, not a particular set of investments.

Sustainable and responsible opportunities are now available across an increasingly wide range of investment types. Established ethical investments are being joined by new options like climate change funds, sustainable property and microfinance funds.

You may sometimes hear the terms ‘ethical’, ‘green’ or ‘socially responsible’ investing used interchangeably with ‘sustainable’ and ‘responsible’, but they usually mean the same thing. Some people use the phrase ‘green investments’ specifically for investments in renewable energy or environmental (or ‘clean’) technologies.

Why choose sustainable and responsible investing?

Today, a wide range of people choose Fairtrade and organic products part of the time because they are great products in their own right and they help society and the environment at the same time. Similarly, it can make sense for all investors to consider sustainable and responsible investing for at least part of their portfolio.

It can also make good financial sense. ‘Sustainable investing was once regarded as only of appeal to those that were ethically minded. However, with the world undergoing significant change, the issues around sustainability have become so fundamental to today’s global society that the mainstream investment community is increasingly citing sustainable investment themes as the ones that offer the best potential for significant growth,’ according to one experienced fund manager.¹

In addition to this focus on social and environmental trends, the field also includes more traditional approaches like avoiding investments in the defence industry or pornography on moral rather than financial grounds. As with any investment field, it is important to understand the approach being offered by a specific investment and not to make assumptions.

Who uses sustainable and responsible investing?

2010 research by the European Sustainable Investment Forum² (Eurosif) found that an estimated 11 per cent of the portfolios of high net worth investors across Europe were already invested using sustainability criteria. According to Eurosif, this reflected both interest from successful entrepreneurs and inherited wealth that has moved to a younger generation, with the majority influenced most strongly by the financial opportunity offered by sustainable choices.

Experienced advisers in the UK report that, as well as more traditional ethical investors, a wide range of clients are now demanding investments that fit with their personal values. Indeed, over half of British investors want their investments not only to make money but also to make a difference in the world, according to consumer research in autumn 2010.³

What types of techniques are used?

Sustainable and responsible investing techniques used to select investments include the following.

Thematic investing

Picking investments using social and environmental themes where there are business opportunities in helping people or protecting the environment. These themes could include education, climate change or ageing society. Often, they are in areas where social or political pressures may create better business opportunities in the future than in the past. The new area of 'impact investing' described below is one specific type of thematic investing.

Positive screening

Selecting those investment opportunities that deliver better social and/or environmental performance than ones that are otherwise similar to them. This might mean picking the mining company with the best health and safety record, the energy company with the lowest carbon emissions or the commercial property investment that uses the least energy or most contributes to urban regeneration.

Engagement or responsible ownership

Rather than focusing on selecting investments, engagement aims to improve the social and/or environmental features of an investment while it is owned and to ensure that it is well managed so that its long-term value is protected. Engagement is therefore sometimes known as ‘responsible ownership’. This may be achieved by using the power of being an owner to encourage, lobby for or support better business behaviour. It may also include publishing research or rankings of investments to encourage change.

For shareholdings in listed companies, voting at AGMs can be one part of this. Shareholders may also put forward shareholder resolutions to instruct or encourage companies to change if more informal influence is unsuccessful. In the UK, there are usually only a small number of socially or environmentally motivated shareholder resolutions each year but they are much more common in the United States.

Following the financial crisis, financial regulators are concerned to encourage responsible ownership. The world’s first ‘Stewardship Code’ was launched in the UK in 2010. All UK investment managers are now required to state whether or not they follow the Code.⁴

Negative screening

This describes the traditional approach of avoiding particular investments altogether – for example, shares in tobacco manufacturers or publishers of pornography.

What types of sustainable and responsible investments are available?

There is an increasing range of investment types offering sustainable and responsible investing choices for private investors. Active and passive strategies are available. Asset classes include shares, bonds and property.

Collective investment funds and discretionary portfolio management services

Subject to your social and environmental interests, collective investment funds such as unit trusts and open-ended investment companies (OEICs) are available in at least a dozen of the investment sectors classified by the Investment Management Association. (See Table 6.1.1 for details of the investment sectors including ethically screened funds.) Discretionary portfolio management services are also available for those with larger amounts to invest.

TABLE 6.1.1 Investment Management Association: investment sectors with ethical funds

Active Managed
Balanced Managed
Cautious Managed
Europe excluding UK
Europe including UK
Global
Specialist
UK All Companies
UK Equity Income
Unclassified sector
£ Corporate Bond
£ Strategic Bond

Investment sectors containing at least one screened collective investment fund from a member firm of the Investment Management Association at 7 February 2011. This investment sector classification is defined and managed by the Investment Management Association. For current information, visit www.investmentfunds.org.uk/fund-sectors/find-a-fund and select 'Ethical'. This list demonstrates the range of options available and does not necessarily include all investment sectors in which ethical funds are available.

Exchange traded funds

A wide range of indexes with sustainable and responsible themes has been launched over the last few years. Examples are given in Table 6.1.2. Exchange traded funds (ETFs) are available to track some of these indexes. There are ETFs for clean energy companies, water-related businesses, large companies with low carbon emissions compared with others in their industry sector and Sharia-compliant (Islamic) investments.

TABLE 6.1.2 Environmental, social and governance (ESG) indexes: examples

Dow Jones Sustainability Korea Index
MSCI Europe ESG Index
S&P ESG India Index
FTSE4Good Global Index
Saudi Arabian Responsible Competitiveness Index (SARCI)
ECPI Global Longevity Winners Equity Index
Opportunities for the Majority (OM) Index
S&P CNX 500 Shariah Index
MSCI USA Catholic Values Index
Dow Jones Dharma Indexes
FTSE CDP Carbon Strategy All-Share Index
HSBC Optimised Global Water Index
MSCI Global Green Building Index
FTSE Environmental Opportunities All-Share Index

These examples of ESG indexes have been selected to give an illustrative range of the topics covered. They have not been selected for investment purposes, and any associated investment products may not be suitable for all investors. For details about each index and any associated investment products, please consult the index provider where specified or search online.

Property

The sustainable property investment area has ranged from pioneering eco-buildings to healthy low-energy offices and social housing with different products available at different times. Sustainable property funds may have a focus on issues such as environmental performance, urban regeneration, social housing or other societal impacts.

Other

Other investment options include some forestry investments, bond funds to raise capital for social projects and microfinance funds. And some investors are ‘green business angels’, investing directly in new small businesses delivering social and/or environmental benefits.

Investment structures

Tax-efficient structures like ISAs and Enterprise Investment Scheme (EIS) investments are available. Vehicles like Venture Capital Trusts (VCTs) and Real Estate Investment Trusts (REITs) may also be used.

Many stakeholder pensions and personal pensions offer sustainable and responsible options. A wider choice of sustainable and responsible investments may be held within a self-invested personal pension (SIPP).

Give me examples of sustainable and responsible investments available today

Examples of investments tackling particular social and environmental priorities include the following.

Climate change and environmental markets funds

There is a range of different investment techniques described today as ‘climate change funds’ or ‘environmental markets’ investments.

Some funds invest in ‘environmental solutions’, eg companies providing the environmental technologies and services likely to benefit from tighter regulation of carbon emissions and/or other environmental issues. There is a variety of such funds, including those with a broad remit and others with a specific focus such as sustainable water funds.

Other climate change funds invest in large companies that are leaders in managing their environmental impacts.

A climate change or environmental markets fund’s investment strategy may or may not include any further negative or positive screening. For example, if you particularly support or object to nuclear power, you may wish to consider whether a particular climate change or environmental technology fund will include or exclude this form of energy generation. Similarly, you may wish to understand whether a fund investing in companies that are ‘low carbon leaders’ assesses performance on wider issues such as child labour. The fund literature should make this clear – if no information is provided then it is reasonable to assume that no specific criteria exist.

In the future, there may be a wider range of climate change investments. Significant capital will be needed for energy-efficient upgrades to existing housing and other property, and for low-carbon infrastructure such as smart electricity grids and charging points for electric cars. This may result in governments and companies issuing fixed interest ‘climate bonds’ either directly to private investors or to fund managers who may then offer fixed income climate change funds. And policy makers are looking for ways to give financial returns from sustainable forestry by valuing the ‘ecosystem services’ and ‘carbon capture’ that forests provide as well as their value when felled.

Sustainable thematic funds

Sustainable thematic funds invest across a wider range of themes than climate change or environmental management funds. These usually include both social and environmental trends.

Fund titles vary but may include words like ‘future’, ‘sustainable’ or ‘eco’. Fund managers say that using a breadth of themes gives greater flexibility in selecting industries or, where appropriate, geographical regions offering the most attractive investment prospects over time. If pricing in some industries or technologies becomes unattractive, then they can rebalance the relative emphasis on different themes until the situation changes.

Screened collective investment funds (‘ethical funds’)

Broadly based ‘ethical funds’ use a selection of environmental, social and/or ethical issues together with conventional financial criteria to select suitable shares, bonds and/or other investments. They will usually use both negative screening and positive techniques, and may also use engagement.

It is possible to select a fund that takes a broad approach to responsible business behaviour. Alternatively, you can use the detailed information available about these funds to pick ones tailored to your specific priorities.

A list of the issues addressed by different funds is available at www.yourethicalmoney.org. A form used by an experienced financial adviser to ask clients about their detailed concerns is available at www.uksif.org. Some funds provide more detailed information about their investment approaches by using the European SRI Transparency Code.⁵

But can sustainable and responsible investments deliver good financial returns?

It is now widely recognized that well-managed sustainable and responsible investments can deliver excellent financial performance.

Specialist financial advisers say that, as with any other investment, the skills of the fund manager are key. According to the Investment Management Association, ‘the performance of ethical funds is just as reliant on good management techniques as that of conventional funds’.⁶ And 90 per cent of wealth managers responding to a 2009 survey said that their sustainable and responsible investing portfolios had performed the same as or better than their other portfolios.⁷

Some sustainable and responsible investments have a track record going back over 25 years, demonstrating that they can perform across a range of market conditions. Over short time periods, like other portfolios run according to investment convictions, a sustainable and responsible investment portfolio may vary above or below a conventional benchmark for a period of time.

Because sustainable and responsible investing is an investment style or philosophy and not restricted to a particular investment sector, the financial performance of a particular sustainable and responsible investment product should always be compared with another with equivalent financial characteristics. As with other investments, it does not make sense to judge a fund manager by comparing the performance of, say, a fund seeking dividend income from UK companies with another investing globally for capital growth.

There are strong arguments for thinking that sustainable and responsible investments may deliver superior financial performance in the future. This is because they address the implications for business of tomorrow's key social and environmental drivers. For example, the shift to a low-carbon economy will result in major changes to how companies operate and the products and services they sell. There will be winners and losers. Managers of sustainable and responsible investments are already considering where the profitable opportunities lie in this shifting landscape. They are assessing which companies manage their social impact well today and how easily they can respond to tomorrow's challenges.

What should I do if I am more concerned about social and environmental impact than financial return?

In the past, investors usually aimed to make as much money as possible from their investments – and then perhaps gave some of this away to good causes. Recently, a middle way is starting to emerge where some investors are putting aside a proportion of their wealth to invest mainly for the social and environmental impact achieved. This new area of 'high social impact investing' or 'impact investing' is attracting attention from individuals who have, for example, sold businesses or inherited wealth and wish to put some of their money to work doing good in a different way from charitable donations.

One impact investing adviser says: 'In addition to offering considerable social and environmental benefits, these investments are also appealing on a number of financial fronts. Impact investments often operate in geographic areas and sectors outside the financial mainstream, which are thus less correlated to other asset classes. Incorporating impact investment strategies into portfolio management can lead to better diversification. They can also appeal because these are not volatile instruments requiring delicate market timing or active portfolio management.'⁸

TABLE 6.1.3 Considering sustainable and responsible investing: a five-step process

Step 1 – your investment aims. Consider why you are interested in sustainable and responsible investing. Is it to make money or to make a difference in the world – or a combination of the two? Do you want to have a positive impact or are you more concerned to avoid activities that you dislike – or both? Is this something that you want to consider for all your investments or just for a proportion of them?

Step 2 – your social and/or environmental priorities. Consider what aspects of society and the environment you want to take into account. Your response to the first step may affect this. Are you most interested in the impact of your investments on people or the planet? Are you particularly attracted to new business solutions to today's problems? Are your interests fairly general or do you feel really passionate about some things, like opportunities for young people, climate change or the treatment of animals?

Step 3 – your preferred approaches. Consider what type of investment strategy most attracts you as the way to put your priorities into action. Is it backing certain investment themes? Is it picking bigger companies that are most committed to doing their bit? Is it using ownership power? Is it avoiding some investments? Is it a mixture of these?

Step 4 – your financial objectives. Having thought through what you want to achieve and how, it is important to consider all those financial criteria that are relevant for any investment decision. For example: What are your financial performance objectives? What return are you looking for – and over what timescale? What is your attitude to risk and volatility? What asset mix are you seeking in your portfolio and how might your sustainable and responsible investments best fit into this? How will your sustainable and responsible investments help to address your diversification needs? If these questions are unfamiliar to you, it is worth learning more about financial planning in general or seeking independent advice.

Step 5 – your judgement of best fit. Having identified all of the above, you then need to research the marketplace and pick the investments that best meet your range of needs. The good news is that there is an increasing range of opportunities available – and there are likely to be more in the future.

This process is not intended as a substitute for professional financial advice. If you are considering making a significant investment, we recommend that you consult an independent financial adviser or wealth manager with skills and experience in advising on sustainable and responsible investing.

How should I get started with sustainable and responsible investing?

If you use an independent financial adviser or wealth manager, it makes sense to start by asking how they can help. Do explore what knowledge and experience they have in the field. For example, they might have done UKSIF's online investment advice course. Or they might be certified to the international standard for personal financial planning (ISO 22222), which requires them to ask clients about whether they should take any social, ethical, environmental or religious issues into account. Check how up to date they are – the area has developed a lot in the last few years.

If you don't wish to use an existing adviser, you might consider a financial adviser who is a member of the Ethical Investment Association (EIA). Advisers in this association are committed to increasing access to sustainable and responsible investment advice for individuals, businesses and charities, and to increasing and improving their own professional knowledge.

Private client investment managers and stockbrokers who manage sustainable and responsible investments may be members of UKSIF, the sustainable investment and finance association, listed at www.yourethicalmoney.org and/or accessible through Ethical Screening's services for private investors.

If you want to understand the social and environmental characteristics of the stocks in your existing portfolio, Ethical Screening's private investor service might be appropriate.

Of course, it is important to blend your social, environmental and ethical priorities with your financial requirements to get a diversified range of investments that is suitable for you. If you want to explore sustainable and responsible investing without an adviser, you may wish to consider the five-step process given in Table 6.1.3, which is based on UKSIF's free online training course for financial advisers.

What about other financial services?

As well as investments, there are bank accounts, savings, mortgages, credit cards, insurance and other financial services designed to take into account their wider impact on the world. For example, visit www.yourethicalmoney.org (an initiative of the EIRIS Foundation, a charity) to find out more.

How can I find out more?

To explore sustainable and responsible investing and consider how you can get started, there is a range of useful information sources online. See Table 6.1.4 for more details. If you want to read a longer introduction with further useful links, try *Green Money: how to save and invest ethically* (A & C Black Publishers Ltd, 2009) by respected consumer journalist Sarah Pennells (or visit www.savvywoman.co.uk to buy it online).

TABLE 6.1.4 Sources of further information**www.neiw.org**

The site for National Ethical Investment Week, which is run annually by UKSIF, the sustainable investment and finance association, to raise awareness about sustainable and responsible investing. This includes information for private investors that is available throughout the year, although its main function is as an information clearing house for details about what is going on each year during the Week.

www.youethicalmoney.org

A non-profit site that aims to provide you with objective, independent information on sustainable and responsible finance, including investments. It is run by the EIRIS Foundation, a charity with over 25 years of experience in the field.

www.ethicalscreening.com

To check your existing investments against sustainable and responsible investment criteria.

www.holden-partners.co.uk

This financial adviser firm offers a detailed *Guide to Climate Change and Ethical Investing* for free download from their site.

www.eurosif.org/research/sector-reports

For general overviews of environmental, social and governance risks and opportunities faced by companies in a range of industry sectors.

www.thegiin.org

Internationally, the Global Impact Investing Network is at the cutting edge of supporting the emerging specialized field of 'impact investing' that puts social and environmental impact ahead of financial return. Today, impact investing is of particular interest to charitable foundations and those seeking business-driven alternatives to charitable donations. Those active in the UK in impact investing include Triodos Bank (www.triodos.co.uk), ClearlySo (www.clearlyso.com) and, for professional advisers and charitable foundations rather than private individuals, Investing for Good (www.investingforgood.co.uk).

www.ethicalinvestment.org.uk

To find a financial adviser specializing in sustainable and responsible investment.

www.eurosif.org/sri-resources/sri-transparency-code

For signatories to the European SRI Transparency Code.

www.uksif.org

The general website of UKSIF – the sustainable investment and finance association. This includes information on financial organizations that are UKSIF members, tools for financial advisers and other resources.

These websites do not provide financial information about sustainable and responsible investments. Such information is available from standard financial information sources.

This chapter offers a general overview and should not be taken as financial advice or seen as an endorsement of any particular company, organization or individual. While we have sought to ensure this information is correct at time of print, the author and UKSIF do not accept liability for any errors.

Notes

- 1 Michael Fox, The Co-operative Asset Management (see www.ftadviser.com/FinancialAdviser/Investments/Sector/EthicalAndSRI/Features/article/20090910/ec701584-97aa-11de-b57d-0015171400aa/Profit-with-principles.jsp).
- 2 See www.eurosif.org/research/hnwi-a-sustainable-investment.
- 3 See www.neiw.org/about/media-centre/greed-good-green-good-2010s-set-become-decade-financial-responsibility.
- 4 See www.frc.org.uk/corporate/investorgovernance.cfm and www.frc.org.uk/corporate/stewardshipstatements.cfm.
- 5 See www.eurosif.org/sri-resources/sri-transparency-code.
- 6 See PDF at www.investmentfunds.org.uk/consumer-centre/consumer-factsheets/ethical-investing.
- 7 See www.eiris.org/files/press%20releases/HNWIsurveyoct09.pdf.
- 8 Geoff Burnand, Chief Executive, Investing for Good. See www.ftadviser.com/FinancialAdviser/Investments/Sector/EthicalAndSRI/Features/article/20091015/e152d6f6-b289-11de-b38a-00144f2af8e8/Brace-for-impact.jsp.