

## Ethical investing is growing and it's not just about shades of green...



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**In recent weeks we have seen several new ethical / SRI funds launched into the market, all with varying features. As more information becomes available and the popularity of this style of investing grows it is presenting a minefield for advisers trying to navigate through investment solutions to satisfy their client's needs.**

Traditionally ethical funds worked on a negative screen basis excluding key areas such as tobacco, alcohol, gambling and arms. This evolved into funds also including a positive screen to encourage investment into companies which provide a product or service aimed at helping society or the environment. Out of this came terms such as SRI (Socially Responsible Investment) and subsequently more approaches have emerged with different features.

As the field has developed so has the terminology which can add to investor confusion and expectation. Some terminology can have different meanings depending on region. For example, in the UK and Europe SRI investing stands for Sustainable and Responsible Investment or Socially Responsible Investment whilst in the US it refers to Sustainable, Responsible and Impact investing.

So, what do the terms mean? Here's a quick walk through the field of ethical investment categories.

### **Sustainable and Responsible Investment (SRI)**

SRI originally referred to Socially Responsible Investing but it is now defined in the UK by the UK Sustainable Investment and Finance Association as Sustainable and Responsible Investment. The term now covers a wide range of investment strategies that take into account ethical, social and environmental issues.

### **Environmental, Social and Governance (ESG)**

ESG refers to the factors which are considered by some managers when analysing a company.

They will consider environmental criteria, how a company performs as a steward of the natural environment. As an (extreme) example it would not necessarily look to exclude a mining stock as long as the land was returned to its original natural state once mining was complete and the environmental impact was kept to a minimum.

Social criteria looks at how the company treats its employees, suppliers, customers and the communities it operates within. As an example the same mining stock could still be included if it paid its workers fairly, looking after them and actively contribute to the community they operate in.

Governance criteria deals with the company's leadership, executive pay, internal controls and shareholder rights – asking if it acts responsibly in all these areas. As an example does it pay a correct and fair amount of tax or does it take extreme measures to avoid paying tax beyond a sensible tax planning strategy.

ESG Investment will not look to necessarily exclude any areas but will look to invest in companies deemed to act in the most responsible way within the industries in which they are involved.

### **Thematic Investing**

As the title suggests, this refers to investments around a theme with a social or environmental orientation. This normally takes a positive screen approach, for example a water themed fund, which would look to invest in a wide range of products which help to supply clean water and reduce water usage through the provision of a wide range of products and services. Whilst these funds usually check all companies against an ESG criteria there is the possibility that, say, a company making a water filter may also make oil filters which is used in the defence industry. Normally within the ESG

criteria companies would be checked to make sure the overall balance is positive (e.g. less than 5% of revenues come from filters supplied to defence) but clients just need to be aware of such possible trade-offs.

	
<p>Positive screens seek to invest in companies which provide positive contributions to society.</p> <p>For example companies which provide clean energy or are beneficial to society such as providing social housing.</p>	<p>Negative screens exclude companies / sectors based on certain measures.</p> <p>For example tobacco stocks, companies involved in animal testing, companies with a negative environmental impact.</p>

### Impact Investing

This is a subset of SRI but whilst SRI investing seeks to avoid products or services deemed harmful, Impact Investing seeks to actively make a positive impact through investment; with the intention of making both a measurable social or environmental impact and financial gain.

The breadth of impact investing is wide, with investments ranging from clean energy to community projects such as a social housing. Traditionally impact investing has been the domain of high net worth clients investing directly into illiquid companies or projects and it was often viewed as an extension of philanthropy. In recent years however, this area of the market has grown and it has become available to more mainstream investors through funds or in some cases crowd-funding projects.

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### So... what does it all mean for investors?

We would suggest advisers don't take fund titles at face value, but drill down to ensure the client's ethical requirements are met.

### The Whitechurch Way

At Whitechurch we have taken the approach of using a negative screen to remove funds that invest in a range of criteria which most clients wish to avoid, and have selected funds which tend to also have a positive overlay. Our higher risk level portfolios may use some thematic funds which by their nature will exclude many areas. The funds used also have stringent ESG screening criteria and are screened by the Ethical Screening company. Our portfolios are available through our range of investment management services.

Whitechurch Investment Team, April 2016