INTRODUCTION TO ETHICAL INVESTING

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Responsible investing, also known as ethical investing or sustainable investing, is a holistic approach to investing, where social, environmental, corporate governance and ethical factors are considered alongside financial performance when making an investment.

There are many different ways to engage in responsible investments, and most investors use a combination of strategies including negative or positive screening; environmental, social and governance (ESG) integration; and impact investing.

Anyone can be a responsible investor, whether they are individuals choosing where to put their retirement savings; a trustee of a trust or foundation; or an institutional investor such as a super fund, fund manager, bank or asset manager.

WHAT IS RESPONSIBLE AND ETHICAL INVESTING?

Responsible investing, also known as ethical investing or sustainable investing, describes a holistic approach to investing, where social, environmental, corporate governance and ethical factors are considered alongside financial performance, when making an investment.

Examples of responsible investing vary broadly and could include:

- divesting from a company with a poor human rights record;
- engaging with a company included in an investment portfolio around its exposure to carbon intensive industries;
- making an investment in a program or social enterprise that is focused on tackling a pressing social or environmental issue; or
- analysing and selecting a portfolio of companies to invest in based on their overall environmental, social and governance performance.

Investors engage in responsible investing for a range of reasons including: to align investments with their own or their clients' personal values and ethics; to reduce risk; and to achieve strong financial returns in the short and long term.

WHY RESPONSIBLE INVESTING?

All businesses, and therefore all investments, have an impact on people and the planet, both positive and negative. Responsible investing seeks to minimise the negative effects generated by business and promote positive impacts, ultimately delivering a healthier economy, society and environment alongside stronger financial returns.

Simply put, responsible investing is good for business, and investors are realising the materiality of social and environmental themes in determining the risk and return profile of an investment.

Companies or assets are unlikely to thrive if they ignore environmental issues (such as pollution, climate change, water and other resources scarcity), social issues (for example, local communities, employees, health and safety), governance issues (such as prudent management, business ethics, corruption, strong boards and appropriate executive pay) or ethical issues.

It's quite simple, companies that do the right thing tend to out perform, and we can always refer to history as an example. History has shown how controversial ESG events within companies has led to many stock crashes — Volkswagen being one prime example after their emissions scandal in 2015. In absolute cases it can even lead to an entire collapse, such as the fall of Enron after an internal control scandal in 2001.

Responsible investment is also increasingly being considered part of investors' fiduciary duty to their beneficiaries and clients.

"Sustainable investing is a long-term trend that every investor needs to consider"
- Andrew McAuley, Credit Suisse Private Banking CIO

WHAT ARE THE DIFFERENT TYPES OF RESPONSIBLE INVESTMENTS?

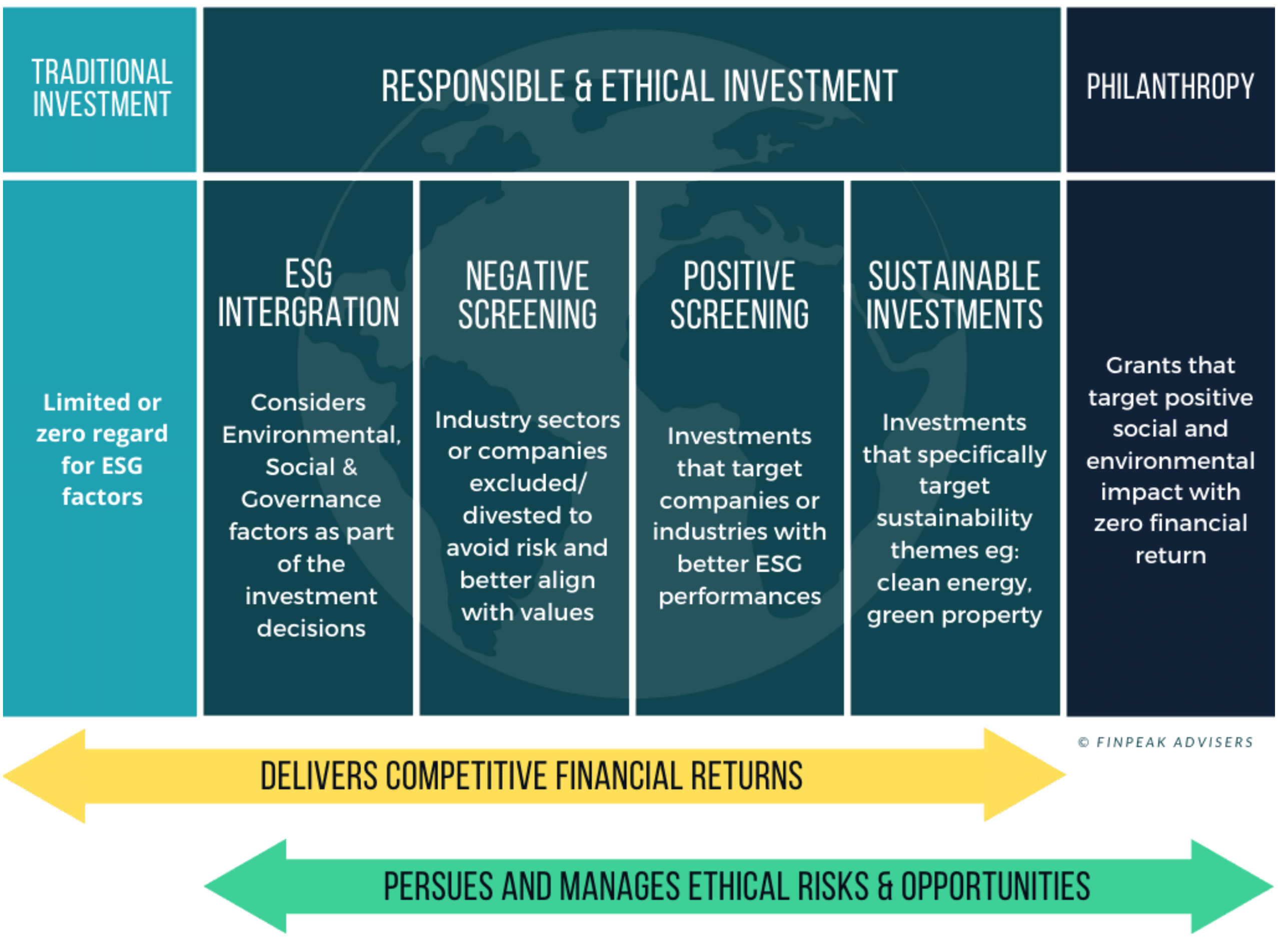
The term "ethical, responsible and sustainable investing" is defined on a spectrum and will mean something different to each individual.

There are many different ways to engage in ethical investing, and investors often use a combination of strategies including:

ESG integration: involves the systematic and explicit inclusion of environmental, social and governance (ESG) factors into traditional financial analysis and investment decision-making by investment managers. This approach rests on the belief that these factors are a core driver of investment risk and opportunity, rather than being driven by ethical considerations.

Negative or exclusionary screening: screening that systematically excludes specific industries, sectors, companies, practices, countries or jurisdictions from funds that do not align with the responsible investment goals. This approach is also referred to as values-based or ethical screening, as well as divestment. Common criteria used in negative screening include gaming, alcohol, tobacco, fossil fuels, weapons, pornography and animal testing.

Positive screening: screening in sectors, companies or projects selected for positive ESG or sustainability performance relative to industry peers. It may also be referred to as best-in-class screening. It involves identifying companies with superior ESG performance from a variety of industries and markets.



Norms-based screening: involves the screening of investments that do not meet minimum standards of business practice, usually based on international norms and conventions such as those defined by the United Nations (UN). In practice, norms-based screening may involve the exclusion of companies that contravene the UN Convention on Cluster Munitions, as well as positive screening based on ESG criteria developed through international bodies such as
the UNGC (UN Global Compact), ILO (International Labour Organisation) and UNICEF (UN Children's Fund).

Corporate engagement and shareholder action: refers to the employment of shareholder power to influence a company's behaviour. This may be conducted through direct corporate engagement such as communications with senior management or boards, filing and voting on shareholder proposals and proxy voting in alignment with comprehensive ESG guidelines.

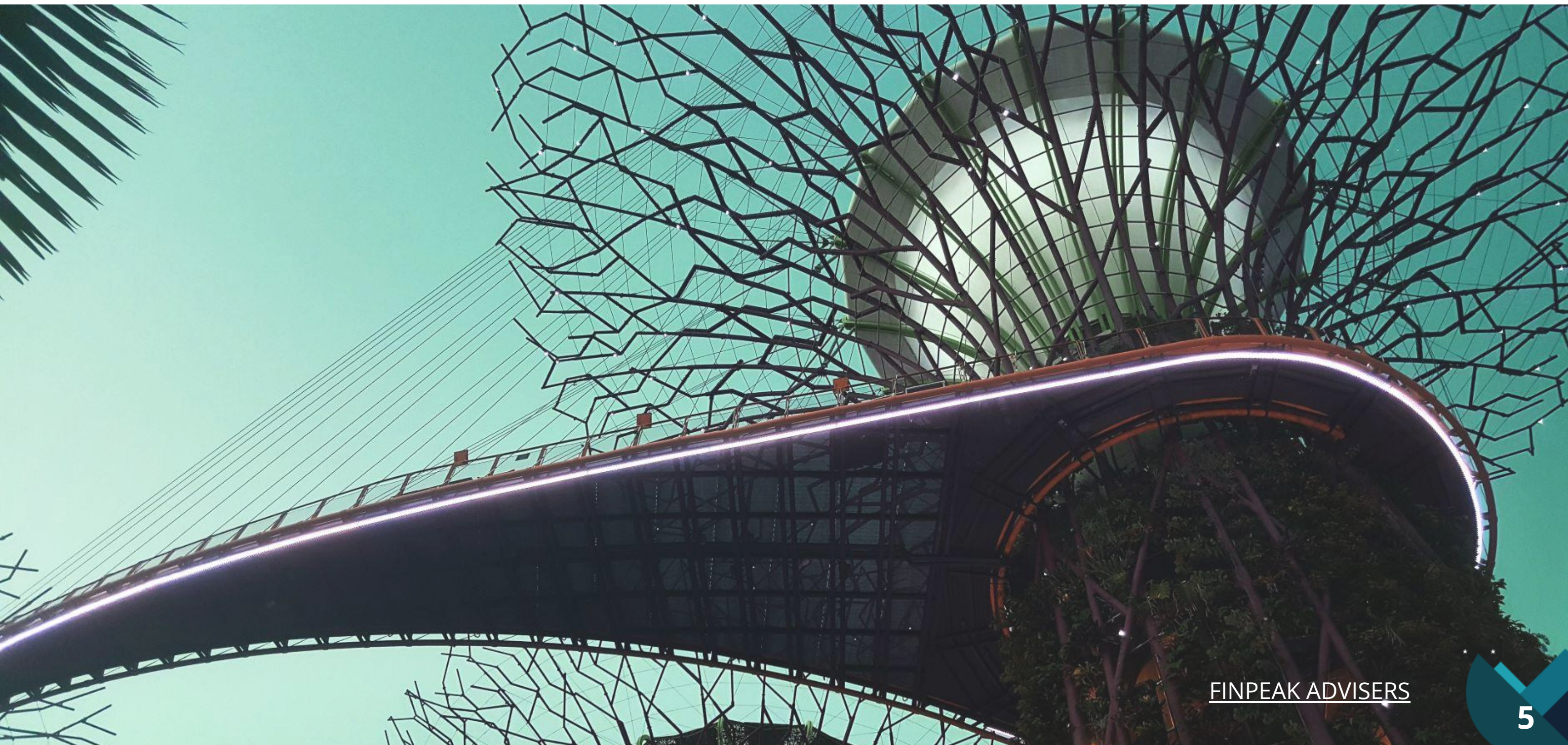
Sustainability themed investing: relates to investment in themes or assets that specifically relate to sustainability themes. This commonly involves funds that invest in clean energy, green technology, sustainable agriculture and forestry, green property or water technology where the fund has the explicit objective of driving improved sustainability outcomes alongside financial returns.

Impact investing: targeted investments made into organisations, projects or funds with the intention of generating positive, measurable social and environmental outcomes, alongside a financial return.

HOW BIG IS THE RESPONSIBLE INVESTING MARKET?

Assets managed in accordance with responsible investment principles now represent 44% ($980 billion) of Australia's total $2.25 trillion assets under management (AUM). This compares with the $178 billion invested in responsible funds at the end of 2013, which at the time, represented just 17% of the total AUM.

The growth in responsible investment in Australasia reflects broader trends, with global responsible investment assets reaching $US30.7 trillion at the start of 2018 (a 43% increase from 2016), according to data from the Global Sustainable Investment Alliance.



WHAT LEVEL OF CONSUMER DEMAND IS THERE FOR RESPONSIBLE INVESTING?

Consumers are becoming more active in demanding their money be invested responsibly and ethically. In Australia, the overwhelming majority of Australians now expect their savings (87%) and superannuation (86%) to be invested responsibly and ethically, and 3 in 4 people would consider shifting their banking and superannuation to an alternative provider that invests responsibly and ethically.

The industry is only continuing to grow. RIAA's 2020 Impact report revealed that investors would ideally like to increase their proportional allocation towards impact investments more than five-fold to $100 billion over the next five years.

Performance of Ethical Investing

> *As of 2018, Responsible Investment Australian Share funds OUTPERFORMED the large cap share funds over, three, five and ten year time horizons.*
>
> Source: RIAA Impact Benchmark Report 2019

HOW DO RESPONSIBLE INVESTMENTS PERFORM?

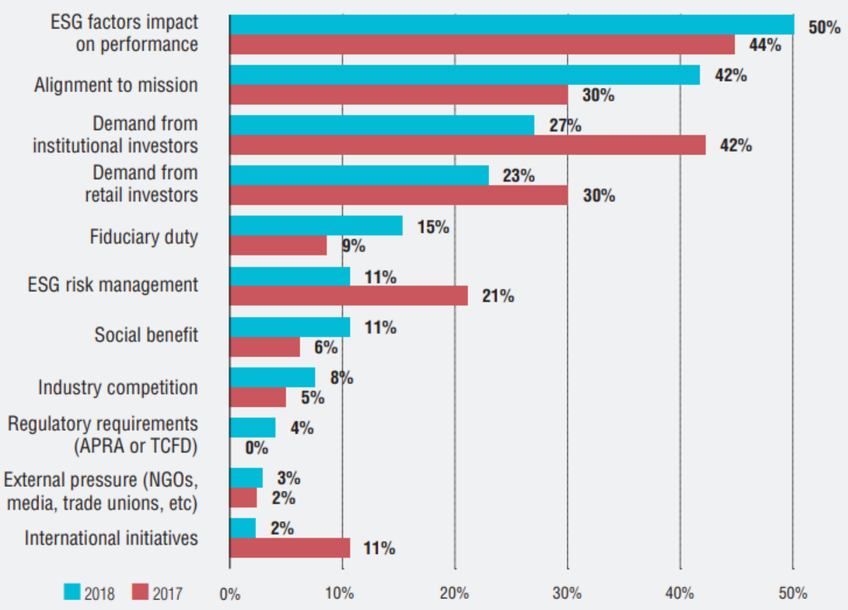
In Australia, responsible investments typically outperform their equivalent mainstream counterparts year on year, over 3, 5 and 10 year horizons. For example, in 2018, Australian equities responsible share funds produced an average return of 6.43% over 5 years and 12.39% over 10 years. This compares with returns of 5.6% and 8.91% respectively for the S&P/ASX 300 index.

DOES ETHICAL INVESTING COMPROMISE RETURNS?

One of the biggest misconceptions is that investing responsibly comes at the cost of financial under performance. As an answer to this Andrew McAuley, chief investment officer of Credit Suisse Private Banking says, "the answer is a clear no". Credit Suisse research shows global companies with an ESG overlay outperform those without one. A 2016 Harvard University study found in 80 per cent of cases there was a proven link between sustainability and share price performance.

To illustrate, RIAA's 2019 Impact Benchmark Report revealed that financial return performance was the key driver for investing ethically. Additionally, it’s entirely possible to have a responsible portfolio as well-diversified as traditional portfolios meaning the proven benefits of portfolio diversification do not fall short.

FIGURE 23: **Key drivers of market growth by those surveyed**



Source: RIAA Impact Benchmark Report 2019

HOW DO I KNOW WHETHER SOMETHING IS A RESPONSIBLE INVESTMENT?

Responsible investment is not a 'one-size fits all' approach. Each responsible investment product or opportunity differs depending on the strategy or methods being used, as well as the particular features of companies or enterprises being invested in. For example, one product's responsible investment credentials may lie in it not investing in tobacco or ammunitions, while another product may be labelled a responsible investment because it solely invests in projects that deliver renewable energy.

The Responsible Investment Association Australasia's Responsible Returns online tool is designed to help consumers find, compare and choose responsible and ethical superannuation, banking and investment products that best match their values and interests. Each product listed on Responsible Returns has been certified in accordance with RIAA's Responsible Investment Certification Program, indicating that a responsible investment product has been independently verified as true to label. Investment advisers are also able to filter products by product type, investment approach, inclusions, exclusions, geography and asset class, in order to identify products right for their clients

WHO CAN MAKE RESPONSIBLE INVESTMENTS?

Anyone can be a responsible investor, whether they are individuals choosing where to bank or put their retirement savings; a trustee of a trust or foundation; or an institutional investor such as a superannuation, bank or an asset manager.

ABOUT FINPEAK ADVISERS

"We live in a world where your life meets your finances"

We are a collaborative wealth management advisory business. We help high net worth individuals and families focus on defining their visions of success, understanding their passions and committing to achieving their goals.

We continuously strive to be at the forefront of changes within the financial services industry, and investment needs of Australians as a whole. This is why responsible investing is an area we specialise in and hold highly at FinPeak.

CONTACT US

If you're ready to start investing ethically or want to find out more, get in touch, we we're ready to help.

Meet FinPeak

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Disclaimer

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References

This document has been in produced with reference to the Responsible Investment Association Australasia (RIAA), you can view the original article here.

Further Reading

RIAA Responsible Investment Benchmark Report Australia 2019
RIAA Responsible Investment Super Study 2019
RIAA Responsible Investment Benchmark Report New Zealand 2019
RIAA impact investment research - various
Global Sustainable Investment Alliance 'Global Sustainable Investment Review 2018

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