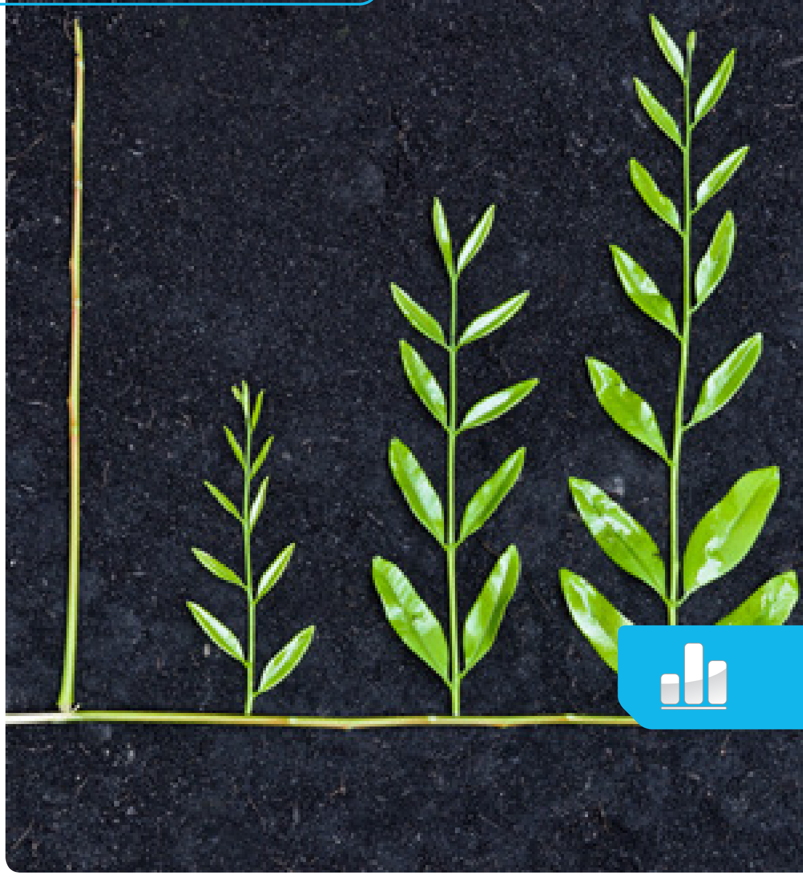

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Ethical investments

An introduction to ethical investments.

Ethical investment funds have a point to prove. Since starting in 1984, the ethical investment market has quickly grown in popularity. By 2015 there was more than £15 billion ethically invested in the UK alone, according to the Ethical Investment Research Service. Ethical investments are viewed as well-suited for people who want their money to sponsor social and environmental change while also giving investors a return in the process.

Ethical funds have proved that profit and social utility aren't contradictory concepts.

Ethical funds

The most common way of making ethical investments is through the use of funds. There are different types of funds available and they use different criteria to screen companies.

Screening

Ethical funds will actively screen listed companies to ensure that they meet ethical guidelines and are eligible to be included in the fund's portfolio. Some funds use positive screening: they include companies based on the social and environmental benefits they provide, either on a global or local level.

Companies that meet the criteria of positive screening will:

- minimise environmental pollution
- adopt specific environmental protection practices
- actively involve themselves in environmental conservation
- treat their workers fairly by working with trade unions and fully meeting their statutory employment obligations.

Some funds use negative screening to determine which companies they will invest in. Companies that fit any of the following criteria will not be looked upon kindly by investment fund managers:

- involvement with environmentally-harmful practices
- profits derived from the creation or sale of weaponry and nuclear armaments
- association with governments with poor human rights records
- involvement in practices that exploit animals
- promotion or sale of dangerous substances such as tobacco or alcohol
- activities considered to be harmful or exploitative such as gambling or pornography.

Ultimately, what constitutes an 'ethical' investment is something you will need to determine for yourself. How you prioritise the positive and negative criteria listed above will affect your options when it comes to ethical investments.

Types of ethical funds

These are the 3 main categories of ethical fund to be aware of.

Light green

These are the least restrictive ethical funds. This allows managers to have more flexibility in which to invest in larger companies which often results in the investor taking on less risk. For those motivated primarily by ethics this could be a downside.

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Light green funds are allowed to include companies which may use pesticides and animal exploitation or participate in the fur trade.

However, involvement in the weapons trade, nuclear energy, tobacco, alcohol, gambling and pornography are generally excluded.

Medium green

These funds are slightly more restrictive than the light green variety. Though investments can be made in certain companies, they are often made in those with a small or medium market capitalisation which heightens the degree of risk.

Most unethical practices are excluded from medium green funds though most will still make investments in companies with poor employment policies and those that produce chemicals that harm the ozone.

Dark green

Dark green funds are considered to be the most ethical and are thus the most restrictive. On top of using the same exclusion criteria as light green and medium green funds, dark green funds may only invest in companies that actively try to provide environmental or social benefits.

Many companies are automatically excluded on the basis that they associate themselves with other companies that breach ethical guidelines.

Before you invest

Treat ethical funds in the same way that you would treat any other fund and do your research. They may be ethical but the principles of good investment remain the same.

There are 3 key areas to research before you make the final decision to invest:

The company

When looking at available funds, make sure you do your research on the company that provides it. Just because they offer ethical funds this doesn't mean that they don't also provide mainstream funds. You will need to determine whether using a fund company that also uses shareholdings in mainstream companies is a problem for you.

Finances

Investing in ethical funds requires that you strike a balance between making your money work for good and getting a return on your investment.

Fund criteria

As discussed above, you'll want to look at the fund criteria in detail before making your decision if ethics are your primary motivator. Because funds tend to frequently screen companies both inside and outside of their portfolio, the companies included in the fund can change. The criteria used by funds may also change during your investment so this is also something to investigate.

Advantages and disadvantages

There are benefits and downsides for being socially responsible with your finances:

Advantages

The 'feel good' factor

The knowledge that your money is doing good in the world is the biggest reason to get involved in the ethical investment market. If you want your principles to reflect in your investments, you can put your money where your mouth is and actively support ethical causes.

Long-term growth

Many portfolios used by ethical funds are made up of companies with potential for long-term growth. Screening helps fund managers to identify those companies who are less vulnerable to the cyclical 'boom and bust' nature of international finance, reducing the volatility.

Less tax

Most ethical funds can be put in an ISA, allowing you to be tax-efficient and have an annual contribution allowance of £15,240 on your ethical investments.

Disadvantages

Potential for less return on your investment

Many ethical funds are expensive than other types of fund. The restrictions placed on many funds may mean that you miss out on better returns on investments in mainstream markets. This is not to say that you can't make a good return but that better deals often exist outside of the ethical market.

No reporting requirements

A lack of statutory reporting obligations means that it is harder to gain an accurate picture of company finances. There are also no uniform guidelines on reporting a business's environmental and social impacts, meaning that investors often have to rely on information provided solely by the business.

Screening can be simplistic

Some screening policies used by ethical funds can be overly simplistic, potentially resulting in investments made in practices that could be seen as unethical. An example is 'environmentally harmful practices' which often doesn't account for behaviour that results in decline of natural resources and negative impacts on ecosystems.

We can provide advice on entering the ethical investment market.