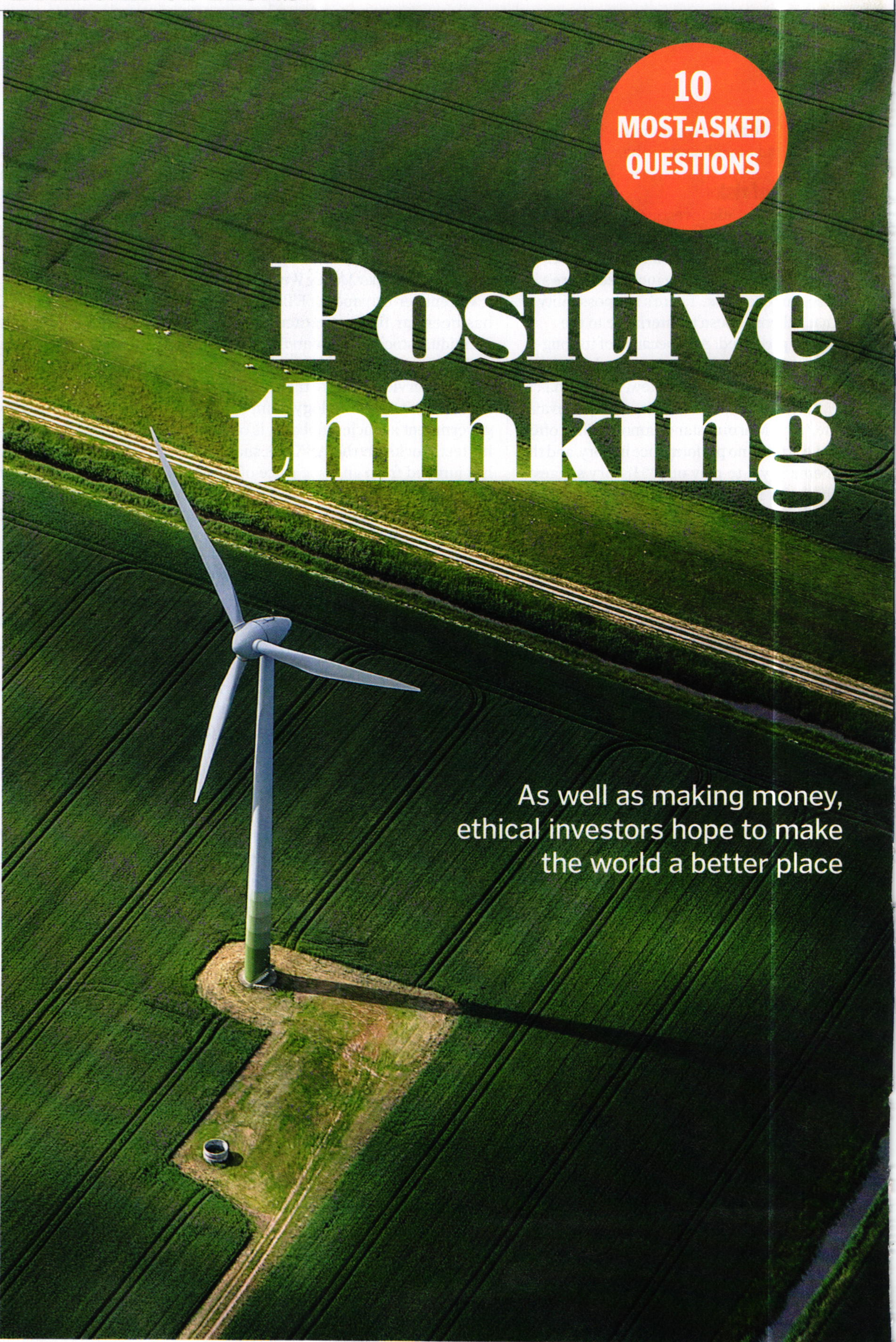
10 MOST-ASKED QUESTIONS

Positive thinking

As well as making money, ethical investors hope to make the world a better place



THE EXPERTS

Josh Callaghan, general manager of wealth, Canstar

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Many studies have found that companies with strong social responsibility policies and practices make good investments

What is ethical investing?

All businesses, and therefore all investments, have an impact on people and the planet, both positive and negative.

Ethical investing, also known as responsible or sustainable investing, seeks to minimise the negative effects generated by business and promote positive impacts. It is a holistic approach to investing, where social, environmental, corporate governance and ethical issues are considered alongside financial performance.

From individuals choosing where to put their savings to a superannuation fund investing money on behalf of its members, investors engage in ethical investing for a range of reasons. These include: to align investments with their own or their clients' personal values and ethics; to reduce risk; to achieve strong financial returns; and to contribute towards delivering a healthier society, environment and economy for current and future generations.

There are many different approaches to ethical investing including negative and positive screening, impact investing and environmental, social and governance (ESG) integration.

SIMON O'CONNOR

What are the different types of ethical investments?

There is a wide range of ethical investment options available to suit your values, including:

- Negative screening. Applying a negative screen to your investment allows you to exclude certain industries. The most common exclusions are tobacco, alcohol, gambling, pornography and weapons.
- Environmental, social and governance. ESG is a fairly broad concept, how it is applied and exactly which criteria are considered will depend on the fund manager. Factors considered may include the company's impact on the environment, their treatment of staff and local communities, and composition of the board.
- Thematic investing. Instead of focusing on exclusions only, or the broad concept of ESG, thematic investments have a clearly defined goal. For example, there's gender lens investing, whose goal is to make investments that support women, or an environmental portfolio that invests solely in renewable energy.
- Impact investing. This style involves making investments that have both a positive impact on society and generate a financial return. For example, investing in companies that are achieving the UN Sustainable Development Goals.

EMILY HOLLINGUM

What investment options are available?

To ethically align your investments you should consider:

- Ethical superannuation fund. Many funds have an ethical investment option available, so check with your current super provider. One of the longest running ethical super funds is Australian Ethical. Today Vision Super offers a low-cost ethical option that is worth considering.
- Exchange traded funds. Investing via ETFs can be a great way to create a well-diversified portfolio with low fees. If you're interested in investing via ETFs, Balance Impact provides a searchable list of global ethical ETFs.
- Actively managed funds. There are a number of actively managed funds available that have responsible investment screens. The Responsible Investment Association of Australasia (RIAA) has a tool that allows you to search for funds that match your goals.
- High-impact, unlisted investments. Impact Investing Hub contains a list of current impact investing funds and direct investments available in Australia. Most of these are low-liquidity, long-term investments. We recommend investing only a small portion of your portfolio (5%-10%) in these.
- Direct investment. You could always do the research yourself and buy shares directly in a company that meets your goals. Yahoo Finance now provides an ESG rating for many Australian companies.

EMILY HOLLINGUM

What should I consider when comparing ethical investment options?

These days consumers are able to use screening to build their own ethical portfolios, or they can buy ethical ETFs or managed funds. When buying an ethical fund, the same rules apply. Investors need to ensure they're not paying too much, the past performance matches expectations and the fund is of a reasonable size. Outside of that, it's then about ensuring the screens being used align with the investor's values and the way in which they want their money invested. Investors should be prepared that there may not be a fund that completely aligns with all of their preferences, so some trade-offs may need to be made. Many funds can make discretionary calls on the companies they invest in, even if it doesn't fit the screen rules, so it's worth keeping an eye on where your money is invested.

JOSH CALLAGHAN

How have ethical funds performed compared with traditional funds?

In addition to rising consumer demand, the reason that much of the finance sector is now considering a responsible and ethical investment approach is quite simply that it makes good investment sense.

In Australia, responsible investment funds are outperforming their average mainstream counterparts year on year, as the market for responsible investment continues to grow.

The Responsible Investment Association Australasia's 2018 Benchmark Report shows "core" (ie, screened and sustainability themed) responsible investment share funds and balanced multi-sector funds both outperformed their equivalent mainstream funds over three-, five- and 10-year horizons.

From Harvard Business School to Bank of America Merrill Lynch, numerous other studies have found that companies with strong corporate social responsibility policies and practices make sound investments. In 2015, Deutsche Asset & Wealth Management and Hamburg University conducted a meta-analysis of over 2000 empirical studies, finding an overwhelmingly positive correlation between environmental, social and governance standards and corporate financial performance.

SIMON O'CONNOR

Q How do the fees compare with those of traditional funds?

There is a wide range of ways to invest ethically: passive, active, direct shares, separately managed accounts, index funds, listed investment companies, exchange traded funds, super funds and managed funds. And costs can be just as varied. The great news is that you can access truly ethical investments that actively seek positive investments and you will often pay the same, or only a little more than for traditional funds. The Ethical Advisers' Co-op has built investments that cost as little as 0.33%pa, which is less than the fee for most standard index funds.

But dollar cost shouldn't always be your main consideration. What good is a 0.1%pa fee saving when poor air quality regularly makes you sick? When your family can't drink or swim in local water because of pollution? When your children can't find suitable work because employers don't hire diverse workforces? When your clothes are made with slave labour in developing countries? Costs can be much higher than the numbers provided on a statement.

CHRIS LANG

Q How do I know if a fund is actually ethical?

In the ethical investing world there are no standardised definitions. Even if a fund excludes an industry from its portfolio, this does not mean that the exposure within your portfolio will be zero. Most funds will use a revenue threshold: for example, a company is excluded if it generates more than 5% revenue from a particular industry. For this reason it is best to read the offer documentation (the product disclosure statement) to see exactly which investments are excluded.

If wading through the small print of offer documents is not your thing, the quickest way to check if a fund is true to label is to download a list of current holdings. If you're trying to exclude fossil fuels but the fund contains Woodside, Caltex and Santos, then no need to read the small print – you can move on to the next fund.

EMILY HOLLINGUM

Q Where can I go for more help to choose or research options?

Our research shows that four in five Australians would consider moving their superannuation or other investments to another provider if their fund engaged in activities inconsistent with their values. However, people often find that there's not enough independent information available regarding switching to a responsible or ethical investment provider.

If you have a financial adviser, find out where your money is currently invested, tell them the issues you care about and ask for recommendations of ethical and responsible investment products.

RIAA created Responsible Returns (responsiblereturns.com.au) to help Australian consumers find, compare and choose responsible and ethical superannuation, banking and investment products that match their interests.

From investing in healthcare and education to avoiding investing in animal testing and fossil fuels, the site allows users to filter products based on their areas of interest.

Over 150 products are listed and each has been certified in accordance with RIAA's responsible investment certification program indicating the product is independently verified as true to label.

SIMON O'CONNOR

Q How can I build a diversified ethical investment portfolio?

You could consider a pre-mixed ethical option, such as Hesta's Eco Pool. However, pre-mixed options may not suit your personal ethical values, have enough asset diversification or fit your appetite for risk. Also, greenwashing in pre-mixed super funds is very common; they often fail to match expectations of an ethical investment.

A better solution is to talk to a financial adviser who specialises in ethical investments. A knowledgeable adviser will build a portfolio to match your values and financial objectives. Concerns you have for the environment, community and society, and how a company treats its workforce can all be reflected using diverse investments and companies. Ethical investing is a complicated and ever-expanding area, and to navigate it well this should be the core business of your adviser. The best place to begin seeking competent specialists is to search for advisers who are members of the Ethical Advisers' Co-operative.

CHRIS LANG

Q What difference does investing in ethical funds/companies make to the world?

Economics is a powerful driver for change in the world. We see this happening in the energy sector – it now costs less to build new solar and wind plants then to continue operating existing coal power plants. This means we are unlikely to see new coal power plants built in Australia again. This is the power of economics. Solar and wind have reached this point because concerned, conscientious investors chose to provide the renewables sector with the funds it needed to research, develop and build these new power sources. Smart investors realise that investing ethically is an easy thing to do, and it is making a huge difference for current and future generations.

CHRIS LANG

For more details on the difference between ethical investing and impact investing, what positive and negative screening mean and tips on choosing an ethical investment visit moneymag.com.au/ethicalinvesting. **M**