Understanding investing: ethical and sustainable investment

A guide for charities

Rathbones
Look forward

The value of investments and the income from them may go down as well as up and you may not get back your original investment. Past performance should not be seen as an indication of future performance.

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Contents

A brief overview of ethical, sustainable and impact investing and the range of approaches that charities can take.

Ethical considerations often play an important role in a charity's investments. Companies with poor environmental, social and governance (ESG) practices are more likely to face regulatory action and fines, which in turn may impact their profitability, dividends and share price volatility. There is also increased potential for future reputational damage if a charity invests in stocks with dubious ethical credentials.

On the other hand, companies that take up the mantle to create solutions to longer-term issues and trends, such as tackling climate change, water scarcity and single-use plastic, can present attractive investment opportunities for charities that choose to invest in them.

Establishing a charity's ethical approach can be a complex task, but it's important that trustees take the time to consider how to align the charity's investment policy with its purpose and values. As part of this, trustees should engage with the charity's investment manager to ensure its ethical strategy can be implemented in a manner that achieves the charity's overall investment objectives.

Defining ethical and sustainable investment

Ethical and sustainable investing can mean different things to different people. As a result, there are a myriad of terms used. In its simplest form, ethical investing could be viewed in one of two ways: how to avoid investing in certain companies or sectors, or how to make positive choices to promote change in some way.

Avoidance, otherwise known as negative screening, refers to the exclusion of certain investments from a charity's portfolio, for example companies involved with harmful activities or products, or that contradict the charity's purposes and aims. Companies who focus on the production of tobacco products, armaments, or those profiting from gambling may fall into this category. To avoid specific types of investment, a charity would typically adopt an ethical exclusion policy.

The other way to think about ethical investing is to consider how to purposefully select investments that make a positive impact. This may involve choosing to invest in companies with good environmental practices, or which provide basic necessities or renewable energy equipment, for example. Depending on the desired balance between financial and social or environmental returns, this can be a very specialist area of investing, which we discuss in more detail later in this guide.

At Rathbones, we tend to think about ethical and sustainable investment as facets of our overall approach to responsible investment. For us, they involve the application of both positive and negative ethical, social and environmental criteria in the management of investment portfolios.

Selecting an ethical investment approach

Of course, there is no one-size-fits-all approach to investing. In fact, there is a broad spectrum of possible approaches that a charity can choose to adopt – from a strategy focused purely on financial return, all the way through to a strategy where impact and purpose take precedence over financial return.

At one end of the spectrum, trustees can seek to manage ESG risks by ensuring that the charity's investment manager considers such issues when selecting investments and actively engages with companies on those issues. For many charities this lighter touch approach is sufficient.

A more embedded approach to responsible investing would involve a two-pronged approach, where trustees choose to avoid investing in certain sectors or industries and, at the same time, actively invest in those companies implementing and evolving good practice around certain ethical and sustainability issues.

Towards the other end of the spectrum, trustees may want to positively invest in those companies that are supporting progress towards a more sustainable world, seeking out opportunities or targeting solutions to some of the big social and environmental challenges that the world faces.

It's important to remember that a more traditional investment strategy focused on financial return with no ethical consideration isn't necessarily irresponsible or unethical. Similarly, a strategy that focuses purely on positive impact doesn't necessarily equate to reduced investment performance.

What's key is that trustees choose an approach that is aligned with the charity's purpose, values and financial objectives.

Looking beyond financial returns

Investors who want to generate measurable, beneficial social or environmental impacts through their investment choices, alongside financial returns, are known as impact investors. They look to invest in ways and in organisations that address regional and global issues such as social housing, renewable energy, sustainable agriculture, accessible finance and healthcare.

Crucially, impact investing goes beyond just considering a company's ESG credentials. It also considers a company's, and the investor's, intention to address sustainability challenges. For example, a company may rank highly in ESG terms with strong workplace policies, board-level gender equality and good resource management, but if the underlying business or product is environmentally damaging or a public health risk, it might be difficult to define it as having an overall positive impact.

This is not to say that companies without a specific mandate to directly address social or environmental issues cannot contribute to sustainable development. For example, they could create social impact by investing in their workforce or environmental impact by limiting production waste. What is important is looking at a company in the whole and considering whether, on balance, it has a positive or negative impact on people and the planet.

Measuring impact

Establishing proof of positive impact is a cornerstone of impact investment. However, there's often a scarcity of available and comparable data, and current reporting requirements mean that impacts are sometimes assessed on incomplete information. Without considering a wide range of measures to understand the relationship between a company's strategy and the actions it takes in practice to implement it, there is a risk of 'impact washing' where organisations publicly align with sustainability trends without necessarily implementing them.

As such, the UN-backed Sustainable Development Goals (SDGs), which concentrate on largely interdependent areas of economic, social and environmental concern, have become a prominent framework for assessing impact. The 17 goals contain 169 core targets, each of which has a specific set of indicators for measuring progress. An emphasis on reporting both the successes and shortcomings of companies in relation to these targets allows impact investors to gauge current results and understand future investment expectations and needs.

Engagement with companies is also central to the impact investment approach, with the role of the investor being as important as the impact of the underlying holdings. Investment capital is an essential requirement for business development; investors can contribute to increased impact by signalling the importance of ESG issues, by engaging directly with companies to highlight issues of concern and encourage change, and by helping to grow the market for impact investments.

The fundamentals of investing

This guide accompanies one of our charity investment training webinar series: Ethical investing and why it's important. You can watch the full webinar by following this link.

Our training webinar series is designed to provide trustees and senior finance staff with an understanding of the fundamentals of charity investment.

Please visit:
rathbones.com/charities to find out more about the training series or to read our other guides.

To find out more about Rathbones' approach to ethical investing, please contact:

Natalie Yapp
natalie.yapp@rathbones.com

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Unless otherwise stated, the information in this document was valid as at March 2021.

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T3-ChGuide1-02-21

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rathbones.com
@Rathbones1742
Rathbone Brothers Plc