

Ethical Investing in Funds

There are now many opportunities to express your ethical views when you invest your money. There are 50 ethical authorised funds in the UK alone.*

This factsheet explains:

- **How ethical funds work.**
- **How they meet the ethical investment criteria.**
- **How to choose an ethical fund.**
- **The impact that investing ethically might have on performance.**

HOW ETHICAL FUNDS WORK

Each ethical fund has a specific set of objectives. Typically, they aim to exclude investment in companies that pose a threat, for example, to the environment, to health or to human rights. However, you can also support good practice by choosing funds which focus on companies that are making a positive contribution, such as those whose products are environmentally friendly or that actively support community welfare. Many funds do both and take account of both negative and positive criteria when investing your money.

HOW ETHICAL FUNDS MEET THE INVESTMENT CRITERIA

A screening process is used to ensure that the companies a fund invests in meet its ethical objectives.

The criteria used by the investment fund manager will help you to identify funds that match your personal concerns. You can see a list of negative and positive criteria in the tables on pages 2 and 3.

Many ethical funds have a panel or committee responsible for setting the criteria and establishing an approved list of companies from which the portfolio manager can select investments. EIRIS, the UK's leading independent provider of research into the ethical status of companies, also helps ethical funds with the ongoing monitoring of investments.

Some ethical funds also use shareholder pressure to bring about changes in company policy. By joining forces with other investors, these funds have successfully influenced several companies to improve their practices. This process is often called corporate governance.

*These 50 funds are classified to IMA sectors. For further information see: www.investmentuk.org/fund-sectors

NEGATIVE CRITERIA

Funds may seek to avoid investing in companies involved in the following:

Animal testing	The testing of cosmetic finished products and ingredients on animals is no longer allowed in the UK, but continues abroad. Some consumers believe animal testing to be equally unacceptable in the production of other chemical products.
Genetic engineering	Genetic engineering and modern biotechnology are perceived by some to be an unacceptable way of manipulating nature.
Health & safety breaches	Investors can show their disapproval of companies that break the rules by avoiding investment in those that have been successfully prosecuted by the Health & Safety Executive.
High environmental impact	Public concern about the degradation of the environment is becoming increasingly widespread.
Human rights	Investors have traditionally boycotted certain countries, but increasingly it is being argued that countries need investment to improve basic social and economic rights. Against this background some people have concerns about the activities of certain companies.
Intensive farming	Many people are concerned about food quality, particularly food contamination (in the wake of BSE), antibiotic residues and the use of growth hormones and pesticides.
Military	Some people believe that the use of military force is unacceptable, either of defensive or offensive purposes.
Nuclear power	The threat of radioactive contamination from an incident at a nuclear power station typifies the concerns many people have about nuclear power.
Pesticides	Excessive pesticide use can lead to the build-up of chemical residues through the food chain, damage to birds and insects, injuries and deaths among farm workers and damage to animal and human immune systems. Some chemicals are also ozone depleting.
Pollution convictions	There has been increasing concern in the last few years about the effects of environmental pollution on health. A small number of prosecutions are carried out against companies each year as a result of non-compliance with a legally issued notice or following a serious pollution incident.
Pornography and adult films	Pornography is often objected to on the grounds that it may deprave, corrupt and degrade, contributing to sexual violence and sex discrimination. There has been rising public concern about Internet pornography and worries about children using the Internet and accessing offensive material.
Sustainable timber	Deforestation, including the clearance of land for agriculture, plantations and development, commercial logging and the collection of fuel wood can have damaging effects on the environment and threaten the survival of certain wildlife.
Third World concerns	Many investors are concerned that too many companies put profits before principles in their dealings with the third world, and that by doing so they are actually contributing to third world poverty and its dependency on developed economies.
Traditional ethical concerns	The production and sale of alcohol and tobacco, as well as profiting from gambling, have concerned some ethical investors for many years.
Water pollution	Often caused by industrial discharges, water pollution has both environmental and social impacts.

Source: Abridged version of 'Choosing an ethical fund', published by EIRIS

POSITIVE CRITERIA

Funds may actively choose to invest in companies that pursue the following:

Communal involvement	There are arguments in favour of identifying and encouraging companies that make a positive effort to contribute to the communities they work in and to society at large, whether via donations or other means. However, not all investors will necessarily share the same priorities as companies in choosing which causes to support.
Corporate governance	Corporate governance provides a framework of accountability to a company's owners, its investors and shareholders. Fundamentally, good corporate governance should facilitate good company performance, ensuring that it is managed in the best interests of its owners.
Disclosure	Investors, the public and government increasingly recognise the need for quality information on corporate policy and practice. For investors to be able to pick and choose between companies, it is essential they have sufficient information to make an informed decision.
Environmental	Public concerns about the degradation of the environment are becoming increasingly widespread. Companies have responded to this in a variety of ways, with a number of initiatives and approaches being adopted.
Equal opportunities	Some companies may have improved their equal opportunity records, ie. by developing a system to monitor effectiveness of equal opportunity policies.
Positive products and services	<p>EIRIS has identified five groups of activity which can be seen as providing basic necessities, environmental products and other services which help in solving problems and making the world a safer place.</p> <p>The five groups are:</p> <ul style="list-style-type: none"> • environmental technology, including products such as machinery for recycling, wind power generators, and pollution abatement technology; • waste disposal companies; • public transport and bicycles, including provision of bus services and maintenance of railway tracks; • safety and protection, for example, alarm systems for elderly people living alone, fire alarms, life jackets and protective clothing; • healthcare, including medicines, hearing aids and spectacles, housing, food and clothing.
Supply chain issues	The quality of working conditions in global supply chains is a high profile issue of concern to many investors. Because many companies are yet to actively address some of these concerns, a helpful indicator of progress is the extent to which a company has developed policies to encourage, maintain and improve working conditions in its supply chain.

Source: Abridged version of 'Choosing an ethical fund', published by EIRIS

HOW TO CHOOSE AN ETHICAL INVESTMENT FUND

The first step when choosing an investment fund is to pick one which is appropriate for your objectives and attitude to risk.

Each fund should state clearly its exclusions and inclusions in the fund documentation, so you can shop around to find one that appeals to you.

Apart from the ethical criteria, you will need to take into account whether the fund will perform in line with your expectations. Most ethical funds invest mainly in shares. Therefore, you need to be able to leave your money invested for a long period – at least five to ten years – and be prepared to see the value of your investment fall as well as rise.

You can search for ethical funds at IMA's Fund search page:

www.investmentuk.org/investor-centre/fundsearch

If you are unsure whether an investment is suitable for you, you should contact a qualified financial adviser for assistance. IMA's Adviser search tool can help you start searching for one:

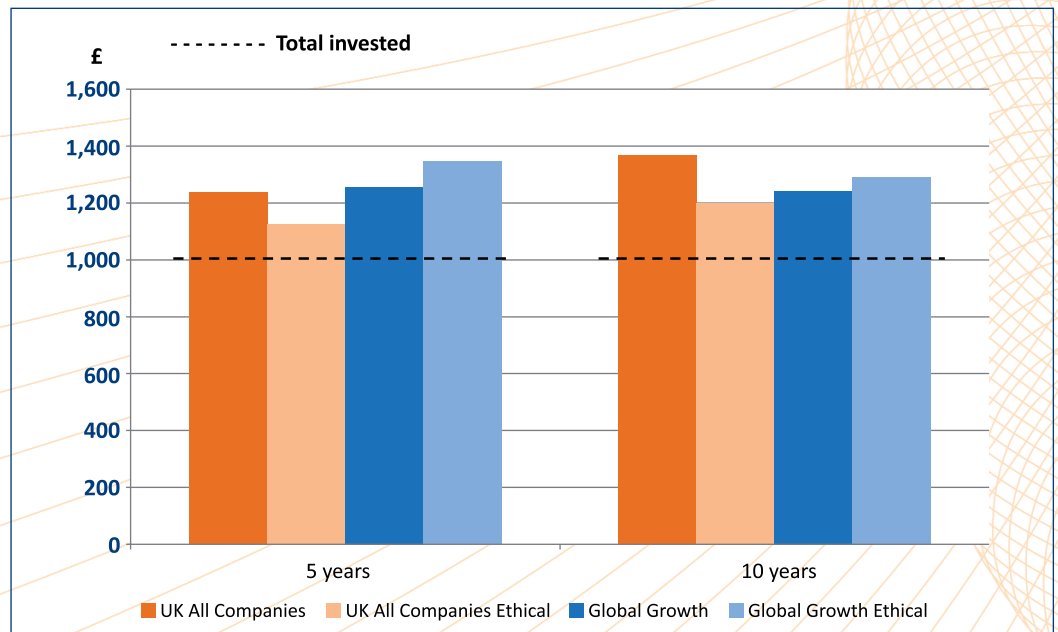
www.investmentuk.org/investor-centre/ifa

INVESTING ETHICALLY: EFFECT ON PERFORMANCE

Investing ethically does not necessarily mean you have to sacrifice investment performance.

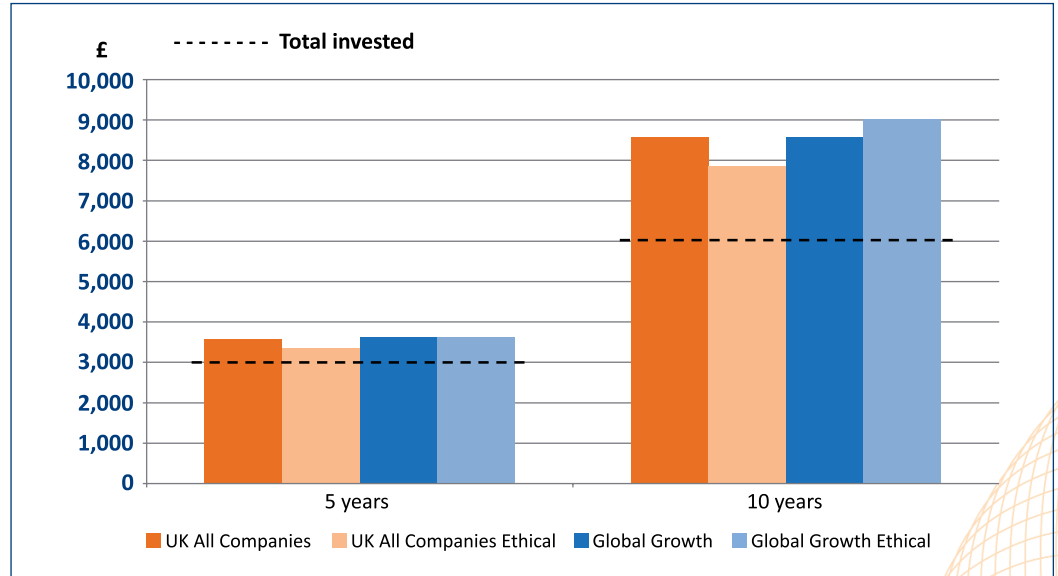
Ethical funds are often perceived to be riskier than their non-ethical counterparts. This is because they tend to hold a higher percentage of shares in small and medium sized companies rather than large companies, and shares in smaller companies can be more volatile than those of larger companies. However, the charts below demonstrate that ethical funds do relatively well.

Performance of ethical funds compared to all funds in the sector over 5 and 10 years, based on an initial lump sum investment of £1,000.



Source: Lipper IM. Average return figures are on a bid-to-bid basis with net income reinvested. Initial charges are not taken into consideration when calculating total return. Data is to 31 December 2010.

Performance of ethical funds compared to all funds in the sector over 5 and 10 years, based on a regular savings plan of £50 per month.



Source: Lipper IM. Average return figures are on a bid-to-bid basis with net income reinvested. Initial charges are not taken into consideration when calculating total return. Data is to 31 December 2010.

Please remember that past performance is not a guide to future performance.

The charts show that over the last ten years, an ethical global fund provided a better return than global funds generally. In an ethical UK fund, however, the returns were not as good as returns from the sector as a whole.

Whether you invest in an ethical or non-ethical fund, the value of your investment will be effected by wider economic conditions and be vulnerable to stock market volatility during the period of your investment. Also some funds will be higher risk than others, and their performance is still reliant on good investment management techniques.

Funds with strict ethical investment criteria may limit performance

Strict ethical screening can exclude, for example, whole industry sectors from investment fund portfolios. This can mean that you miss out on the gains from a particular sector during periods of high growth. These funds are sometimes referred to as 'dark green'.

Some ethical funds adopt a 'light green' or 'best of sector' approach. These funds may invest in larger companies often shunned by traditional ethical funds. The effect is to remove some of the risks associated with investing mainly in smaller companies.

Whichever fund you choose, you will wish to balance your ethical and your investment objectives.

FURTHER INFORMATION

This factsheet is produced by the Investment Management Association. We also publish other factsheets on investing and funds, which you can download free of charge from the IMA's investor website: www.investmentuk.org/investor-centre

If you would like to receive our factsheets by post, contact the IMA Investment FactLine

Website: www.investmentuk.org/investor-centre/investor-factsheets/order-form.

Telephone: 020 7269 4639

To find out more about ethical investing, contact EIRIS. Their dedicated consumer website YourEthicalMoney.org has a searchable database of UK ethical funds, interactive guides to ethical banking, mortgages and insurance, and a database of advisers who specialise in ethical investment.

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