The roots of ethical investing

By Quintin Rayer | September 19, 2019

Early ethical investing was based on religious teaching [1]. Jewish law dating to Biblical times includes the responsibility of owners to prevent immediate and potential harm, while Islamic teaching (609-632CE) has become the source for modern Shariah-compliant investment standards [2]. Historically, several religions have included bans on the practice of lending money for interest. This is usually prohibited in Islamic finance but was also banned in medieval Christian tradition [1].

Western ethical investing tradition has religious roots, notably among the Methodists and Quakers. More recent developments have been in response to the Vietnam War (the 1960s), concerns about nuclear issues (Three Mile Island 1979 and Chernobyl 1986), South African apartheid 1985-1993 [2], global warming, biodiversity and plastic pollution [3].

This article outlines some of the background leading to the modern conception of ethical or sustainable investing.

Western roots

Malthus's 1798 'Essay on the principles of population' warned of population growth outpacing the planet's ability to support human needs [4]. Social concerns about business activity date from the 1700s, with mutual societies and Quaker philanthropists such as Cadbury's. In the 1800s the Quakers prohibited members from participating in the slave trade.

John Wesley's sermon on the 'Use of Money', published in 1872, sets out principles of social investing [5]. He invited fellow worshippers and investors not to harm their neighbour through their business practices and to avoid specific industries that encouraged 'sin'. Association with pawn-broking and the sale of anything which tends to impair health (including guns, liquor and tobacco) were to be avoided.

Recent developments

Typical business activities excluded were the so-called "sextet of sin": alcohol, arms, gambling, nuclear, pornography and tobacco. More recent exclusions include animal testing (both medical and for cosmetics) [6]. Gradually, the list of excluded business widened to include social and environmental problems [7]. The 1972 Stockholm Conference on the Human Environment named the environmental assessment component of its action plan 'Earthwatch', recommending environmental assessment as an operational area of the UN Environment Programme (UNEP).

Business pioneers such as Patagonia (1973), The Body Shop (1976), and Ben & Jerry's ice cream (1978) [8] positioned ethical and social considerations within their offering. The 1980 World Conservation Strategy elaborated the Stockholm recommendations – a collaboration between the International Union for the Conservation of Nature, the World Wildlife Fund and UNEP.

Environment and climate

In 1983, growing realisation in national governments and multilateral institutions of linkage between economic development and environmental issues led to the establishment of the World Commission on Environment and Development by the UN General Assembly. The Montreal Protocol banned chlorofluorocarbons in 1989. In 1992, leaders set out sustainable development principles at the UN Conference on Environment and Development in Rio de Janeiro, Brazil. Three instruments of environmental governance were established: the UN Framework Convention on Climate Change (UNFCCC) [9], the Convention on Biological Diversity (CBD) and the non-legally binding Statement of Forest Principles.

Later in 1992, the UN General Assembly officially created the Commission on Sustainable Development. The 2006 Stern report [10] concluded that the benefits of decisive early action on climate change outweighed the costs. In 2007, the International Panel on Climate Change declared “it is no longer a question of whether climate change policy should be understood in the context of sustainable development goals; it is a question of how”. Carbon emissions play a significant role in climate change. Current efforts may prove to be insufficient to meet the 2015 UN FCCC intended aims of holding the increase in global average temperatures to well below 2°C above pre-industrial levels while pursuing efforts to limit increases to 1.5°C above pre-industrial levels [11]. In 2018 scientists re-iterated the need to contain global warming within 1.5°C [12].

The development of the Faith in Finance movement

The 2017 Zug conference in Switzerland [13], launched an international faith-consistent investment movement to address challenges and opportunities of sustainable development presented by the UN Sustainable Development Goals (UN SDGs) [14].

Delegates represented more than 30 different faiths, with trillions of dollars in assets, United Nations figures and leading impact investment funds. The intention was to enable faith groups to share information and resources to put their investments into initiatives to help create a better world for all. It promoted a proactive policy, ensuring that faith investments have a positive “faith-consistent” impact. Aiming to make money work for good, while still generating the returns they need to fund activities.

Different approaches

The diverse history of ethical investing has led to an extensive range of techniques. Earlier approaches tended to focus on avoiding companies causing harm, while more recent developments often select firms providing solutions and taking beneficial ‘impact’ into account [6]. More sophisticated approaches attempt to judge firms’ relative merits under various criteria, allocating additional risk to undesirable activities and adjusting stock valuations accordingly. However, experience with investors suggests that many prefer the transparency that more straightforward approaches offer.

Sustainable and ESG investment may be useful developments [15]: by emphasising the need for sustainability, ethical investment is placed on a more scientific basis, without the need to lean upon its religious origin. A religious basis for ethical investing could create disagreements about what can be regarded as moral. For example, Islamic finance may prohibit payment of interest, meaning that conventional interest-paying bonds would be unacceptable, although acceptable to some other religions. The value of ESG factors is that they give clarity of focus and provide structure.

How this helps Advisers

The Investment Association reports £19.2 billion assets under management in the UK ethical funds sector in June 2019, a yearly increase of £2.7 billion [16].
With improved understanding of ethical investing's origins, advisers will be better placed to appreciate the motivations of their ethical clients (which may include individuals, charities and trusts), helping them select an approach best suited to their needs.

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