

# Do your investments destroy or care for the planet?

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As an individual, a member of a pension fund, or as a member of an organisation that has investments, do your investments destroy or care for the Earth? Is the present financial system so corrupted that there can be no moral investments? What are the ethical and strategic criteria that you or your organisation should use to select investments? What is wrong with the large majority of socially responsible investments? What investments are sustainable? Which bank should you use? How can you support reform? Why should you care? Do the investments of Quaker and Quaker related funds care for or destroy the planet, and do they when distributing their funds require recipients to care for the planet? This article addresses these questions, and the criteria that you should adopt if you want your investments to protect and nurture the Earth's ecosystems.

## *Why you should care about investment?*

There is considerable scientific evidence of ecological degradation. A wide range of academic and other evidence indicates that there are significant threats to human life, with a likely future of widespread loss of life and a hostile environment for those who survive. There is no consensus among scientists as to when this bleak future may arrive, or whether we have passed a point of no return. However, many leading climate scientists see a 2°C limit as unrealistic: 3-4°C is now a likely minimum. To stay within acceptable limits involves peaking in the very near future, with severe declines in emissions beyond then. Humankind faces a very difficult transition to a healthy and safe future, and any transition will involve major challenges to the financial sector.

Any move away from the goods and services that destroy the Earth, to those activities and products that save it, will require investment. If you care about the future choices for your children and their children and all children, then you will be concerned about whether investment destroys the ecosystems on which human life depends.

## *Why is strong sustainability important?*

The terms 'sustainability' and 'sustainable development' are used in many ways. The Intergovernmental Panel on Climate Change (IPCC) discusses a number of difficulties with the term 'sustainable development' Unfortunately the IPCC adopts a model of weak sustainability, where the three dimensions of economic, social and ecological are seen as independent but linked pillars of sustainable development. The UN principles for climate change, and the UN principles for responsible investment, are based on this model. Unfortunately these do not

recognise the planet's boundaries and limits.

The mainstream neoclassical economic reasoning is based on perpetual economic growth, and the continuing availability of resources for exploitation. This is actually impossible because the biosphere has finite limits, some of which have already been reached. By promising outcomes such as continuous growth and infinite substitutability of scarce resources, economists have influenced the political and economic processes of humanity in ways that are completely at odds to the idea of a resilient and sustainable relationship between humanity and the rest of nature.

The scientifically correct view of the place of human affairs in planetary systems leads inevitably to the need for an economy based on living within the planet's boundaries. Such strong sustainability is the prerequisite and foundation of any human development, whether social, economic or technological. Strong sustainability means the preservation of the integrity of all ecological systems in the biosphere. Ecological integrity means the ability of an ecosystem to recover from disturbance and re-establish its stability, diversity and resilience. A strongly sustainable human society lives and develops as an integral part of ecosystems that have ecological integrity (Sustainable Aotearoa New Zealand, 2009). Any investment that is directed to caring for the Earth needs to be based on a strong sustainable model.

*What is wrong with the large majority of Socially Responsible Investments (SRI)?*

The traditional SRI approach is for the investor to select key values they want to be considered. Certain types of investment can then be excluded. An engagement process can be taken to try to persuade the company to change its behaviour. The investor can also ask for certain positive investments to be made.

For the establishment of sustainable investment, there are problems with the traditional SRI model. EuroSIF estimates that 17.6 per cent (€2.665 trillion) of the European asset management industry can be classified as SRI. However, 14.2 per cent (€2.154 trillion) is reached when there is a single screen, such as weapons, norms-based, or tobacco. The Social Investment Forum USA estimates that 12.2 percent of the \$25.2 trillion in total assets under professional management is SRI (Social Investment Forum, 2010). Of this 82 per cent incorporates environmental, social and governance factors. It is not easy to find out what percentage actually cares for, rather than destroys the planet. A 2005 analysis found that the bulk of USA SRI investment (77 per cent) was simple screening, mainly tobacco, followed by alcohol and gambling. It is likely that less than 5 per cent can be estimated to be ethical, and most probably less than 1 per cent is strongly sustainable.

Many principles and standards established for ethical investment use a weak (if any) definition of sustainability. Many have no adequate content and construct validation processes to show that the standards measure the essential components of what they claim to measure. Many have ranking and scaling processes that give methodologically unjustified weights or values. Most SRI funds allow practically any publicly held corporation to be considered as an SRI

company. The environmental screens used by most portfolio managers are loose and do little to help the environment.

*What is wrong with the majority of Sovereign Wealth Funds (SWF)?*

The largest 50 SWF have \$3891 billion under investment. Just under 60 per cent is oil and gas related. Norway is currently the second largest investor, with \$443 billion or 11 per cent, and is the leader in setting ethical requirements. One of the ethical standards it is required to meet is the avoidance of investment in companies that cause severe environmental damage. The Norwegian Fund has invested in Shell, which is involved in Canadian tar sands extraction. Tar sands extraction is a major contributor to Canadian greenhouse gas emissions, yet no companies have been excluded by the Council of Ethics on the basis of extraction of tar sands. Because the Norwegian Fund excludes only companies causing severe environmental damage, rather than companies that have a high carbon impact and are ecologically unsustainable, investment of SWFs that are strongly sustainable is likely to be less than 5 per cent and closer to less than 1 per cent.

*Is it possible to invest sustainably using a failed financial system?*

During the last few years the international financial system has demonstrated its inability to carry out one of its basic functions, namely, to receive deposits from investors and channel those safely and efficiently to organisations that provide goods and services for the benefit of society at large. This failure is due to the support by significant sectors of the economic academic community, the managers of the financial sector, and the international business and political community, of a model (the general equilibrium theory, the formal theory of the free market) that was shown in the 1950's to be conceptually inadequate. In supporting a failed economic model humanity has lost 30-40 years in planning and executing a transition to a sustainable Earth that will support human life on it as we know it.

However, regulation proposed by many reformers is not sufficient for an adequate transition to a sustainable world or sustainable investment. Regulation which is aimed at only correcting market weaknesses within the existing Business As Usual (BAU) model will not be effective in dealing with the ecological degradation that the Earth is undergoing. A regulated economy still rests upon certain assumptions about the availability and use of resources for human utility, and that economic model is still detrimental to the life systems upon which human life on Earth depends. What is required is the shift from an unlimited growth, to an economy that operates within the planet's boundaries. With this a change in ethics is needed from a utilitarian and a version of Locke's philosophy (with property rights to ownership of resources and exploitation for human utility), to where human-human and human-Earth relationships are based on notions such as respect, integrity, or intrinsic value, and equity.

If the current financial system is based on economic and investment models that are in conflict with modern science, is there any point in investment through the current financial organisations and systems? There is if investments can be made in companies that are part of the solution. If we examine two funds and a bank that take these matters seriously we may start to establish those criteria

which are necessary not only for mainstream financial systems, but private, government and alternative investment options.

#### *Case Study: Portfolio21*

Portfolio21, based in Oregon, USA, has \$322 million in assets in 105 companies. Its investment philosophy is that the greatest risks are the ecological challenges caused by humans consuming beyond the limits of what our natural systems can support. It states that the best long-term investment opportunities are found in companies using environmental frameworks to make business decisions. These companies understand that the Earth's ability to provide natural resources, such as oil, or clean air and water is finite and that BAU is an inadequate response to a likely ecological crisis. The understanding of sustainability principles demonstrates the qualities of innovation and leadership that create a distinct competitive advantage and builds long-term value. Portfolio 21 invests only in companies that are integrating environmental strategies into their overall business planning.

Portfolio21 chooses companies that meet their environmental selection criteria with respect to eight factors. First, does the company's business model plan to gain competitive advantages within ecological constraints? Second, does the company understand the ecological impact of its products and/or services and has taken significant steps to reduce those impacts? Third, has the company demonstrated an environmental commitment through its investments, such as significant investments in the research and development of ecologically superior products or technologies, or in new plants or equipment with advanced environmental performance? Fourth, does the company's management understand the magnitude of the ecological crisis and do they view environmental sustainability as a major business opportunity? Fifth, does the company's environmental management system identify and address environmental impacts and liabilities, develop action plans and procedures, and establish environmental accounting practices that are publicly reported and certified? Sixth, is the company concerned about resource efficiency? Seventh, does the company's strategic plan include reducing direct and indirect greenhouse gas emissions, and decreasing exposure to other environmental liabilities? Eighth, does the company meet good standards in the areas of employee relations, human rights, community involvement, or product safety? Excluded on this latter criterion are nuclear energy, tobacco, gambling, or weapons companies.

Portfolio 21 asserts that there are no truly sustainable companies: therefore no companies excel in all of the areas listed. They select companies with strengths in multiple areas that are well positioned to make further advancements in addressing sustainability challenges. They place the most emphasis on a company's biggest impacts.

#### *Case Study: Highwater Global Fund*

Paul Hawken has an international reputation as an environmental author and activist. His *Natural Capitalism: Creating the Next Industrial Revolution*, and *The Ecology of Commerce: A Declaration of Sustainability* illustrate his understanding of the threats to the health of the planet and the role of business. The

establishment of Highwater Global Fund in 2005, with Michael Baldwin, is an extension of that understanding and action. The fund invests in companies to provide solutions for environmental and social challenges

Highwater Global Fund has a three-stage selection process. The first stage is to determine the intentionality of the candidate company. Does the company provide innovative services and products that address the current and future needs of people and the Earth? Does it address climate change and carbon emissions? Does it work proactively to minimise natural resource use through resource productivity? Does it facilitate a shift from an economy of consumption to an economy of well being? Does it integrate and demonstrate a social and environmental commitment in corporate values and stated objectives? The majority of companies are excluded because of unacceptable activities such as human rights violations; the production of hazardous waste; industrial agriculture; animal cruelty; and corruption. From a field of over 5000 global public equities, around 350 were selected for the next step.

The second stage is an assessment of whether the remaining candidates are innovators, shifters or neutrally good. Innovators are companies concerned with advanced research, technology and services.

The third stage is scoring the companies on a scale of 1 to 10 for 12 categories (leadership; employees; supply chain; community; diversity and women; intention; customers; materials; energy; water; climate; products and services) and over 200 factors, and making a final selection of 30-40 companies. The rating is not the only deciding factor, and some companies are chosen when their scores are less favorable than other candidates’.

#### *Case Study: HSBC Holdings*

HSBC is one of the largest banking and financial services organisations in the world. In 2005, HSBC became the first bank and FTSE100 company to become carbon neutral. It has four-year targets for energy use, water use, waste and carbon dioxide, and programmes in place to reduce the direct environmental impact. This includes the energy, water, waste and carbon emissions from their 10,000 buildings, IT infrastructure and business travel.

HSBC says tackling climate change will require a concerted effort between government, business and individuals. Innovation in renewable energy and clean technology is required to help reduce the world's dependence on carbon intensive fuels. Through lending, investment and insurance products and services, HSBC anticipates playing a leading role in the transition to a lower carbon economy over the long term. The impacts of climate change can already be seen and there will be a need to invest in adaptation, particularly in the developing world.

Key actions that HSBC has undertaken to prepare the business and their customers for the impacts of climate change include the HSBC Climate Change Centre of Excellence; adoption of the UN Climate Principles; five-year partnerships costing US\$100 million with four leading climate NGOs; and the establishment of the HSBC Global Climate Change Benchmark Index.

In 2003, HSBC adopted the Equator Principles for large projects. HSBC voluntarily extended the Principles to export finance loans and other facilities where the use of proceeds is known to be directly related to a project. In addition, HSBC has developed a series of risk policies for sensitive sectors, including Chemicals, Defence, Energy, Forest Land and Forest Products, Freshwater Infrastructure and Mining and Metals. These policies cover a wider range of financial services than lending and are applied regardless of the value of the transaction or size of the business

HSBC has taken a number of initiatives that deserve support: setting up research teams; partnering with NGOs; committing to climate change principles based on a low carbon economy; and establishing a Climate Change Benchmark Index. These actions indicate that HSBC understands the real threat of ecological degradation, and is prepared to give major commitment to this concern, although I do not know where it stands on the weak/strong sustainability question. It is significant that HSBC felt it needed to adopt climate change principles based on a low carbon economy: the UN Principles for Responsible Investment were obviously not sufficient. It is also significant that it recognised that mitigation now is not sufficient, and that adaptation is also required, particularly for developing countries.

Its development of policy for Chemicals, Defence, Energy, Forest Land and Forest Products, Freshwater Infrastructure, and Mining and Metals, is to be encouraged. Some of these are very good: the Defence, and Forest Land and Forest Products, are examples. Others can be best described as a start.

*What are the moral and strategic criteria that you or your organisation should use to select investments?*

While it is possible to argue over some details of Portfolio21's and Highwater Global Fund's application of their principles, the broader picture is that their approaches provide useful insights for sustainable investment. Given Portfolio21's assertion that there are no fully sustainable companies to invest in, it is therefore important to support and encourage those companies that aim to be sustainable, and engage with them to make the changes. Principles, standards, guidelines and benchmarks based on strong rather than weak sustainability are important in this respect. Many international standards are inadequate. Both funds can provide useful models for extending sustainable investment.

Banks provide important investment for the transition to sustainability. The case study of HSBC shows that there is much work to be done, particularly in regard to policies for energy, mining and forestry. HSBC had good policies for forestry, but not for mining and energy. There are other bank models that could be considered: see for example the Global Alliance for Banking on Values which is a group of ten banks with combined assets of \$10 billion, operating in 20 countries.

However, the focus needs to be on the majority of banks that are not performing well. In a survey of 16 US and 24 non-US banks representing more than 60 per cent of the total market capitalisation of the global publicly traded banking sector, it was found that many of the 40 banks have done little or nothing to elevate

climate change as a governance priority. Cogan has written that “while many banks have made improvements, the actions to date are the tip of the iceberg of what is needed to reduce greenhouse gas emissions consistent with targets scientists say are needed to avoid the dangerous impacts of climate change”. The example of HSBC identifies the policy changes that are needed.

The obstacles for a smooth transition to a sustainable financial sector are considerable. The changes involve foundational changes to the international political, economic and ethical decision-making structures and processes, and changes of this type occur infrequently and usually at times of major upheaval. Mitigation alone is no longer adequate: adaptation is required. The indications are that climate change and the trends in ecological degradation will bring widespread disorder and disruption. During the next few decades and beyond, large loss of human life and deterioration in living standards is likely. Many of the goods that currently make up international trade patterns will disappear, as floods and storms, rising seawater, lack of water, and pollution destroy factories or production sites.

Prudent investment will be in goods and services essential for simple and sustainable living, with a focus on local resources and production in the areas of food, housing, clothing, and water and energy systems. (This calls for simpler and less complicated low-carbon and clean-tech industries.) Production and distribution systems will need to be resilient, and able to cope with relatively rapid changes in temperature and weather. Transport and communication systems currently dependent on unsustainable energy and resource use will disappear. Investment needs to recognise the structural changes that will come through the global drivers associated with ecological degradation and resource limits, and that these will be more important than the usual business cycles.

*What criteria should I use for investing to care for the planet?*

Criteria should describe the type of investments that you want to exclude, where you want to engage with companies with the intention of bringing change, and the type of companies that you want to encourage. Negative screens will likely include organisations involved in industries like armaments and weapons systems; nuclear power; gambling; tobacco; animal exploitation and experimentation; irresponsible alcohol manufacture and distribution; significant human rights abuses; significant environment abuses, high carbon emissions. Engagement will involve selecting those companies which may be in your negative screen, but who you want to work with to change. Positive Screens will likely include organisations involved in industries like environmentally sustainable goods and services; clean technologies; renewable energies; green business; progressive employment practices; local community activities; public goods such as public transport; sustainable housing; companies with low carbon emissions.

In addition to the selection of screens, your criteria should include how companies have dealt with the strategic risk they face. A risk analysis is needed to take account of the factors that will significantly influence future conditions and events, both positive and negative, especially in the medium to longer term. The major global drivers will include population change; climate change; price increases for hydrocarbons; water; food; toxins; geopolitical shifts; wide swings in

economic activity and technological advances. Ideally, companies have calculated their ecological impact, are living within it and have incorporated the major global drivers into their strategic planning. There will be complex interactions amongst all of these drivers that will cause abrupt and radical shifts in human living and work, creating risks and opportunities.

Strategies to cope with this turbulence and volatility of returns will include investing in a smaller number of companies, taking a larger weighting, and/or engagement where management is encouraged to take a longer-term perspective rather than a short term requirement to pay out regular or high dividends. The choice of company or fund will include how aware its management is of the major global drivers and how they are incorporating these into their strategic plans. When reporting, there will be an account of how each investment deals with strategic risk.

The principles of environmental sustainability will favour investment in goods and services essential for simple and sustainable living with a focus on local resources and production regarding factors as food, housing, water and energy systems and clothing. Investment will favour production and distribution systems that are resilient and able to cope with relatively rapid changes in temperature and weather. Also favoured will be transport and communication systems that are not dependent on unsustainable energy and resource use.

#### *Working together for change*

The Earth's systems are not resilient enough to cope with the damage that humans have done to them. Currently, investment funds and banks, including SRI funds and sovereign wealth funds, are part of the problem. Consideration of Highwater Global Fund, Portfolio21, and HSBC Holdings illustrates these problems, and points to some solutions. Adoption of principles, standards, benchmarks and guidelines needs to include strong sustainability as an essential component. Criteria for the selection of companies that aim to be strongly sustainable are necessary, but it is just as important that the operationalisation, engagement, monitoring and reporting be carried out properly. There is considerable room for improvement, particularly in the development of energy (including transportation), mining, forestry, and agribusiness policies and investment. Unfortunately a rapid shift to sustainable investment is unlikely until the impacts of ecological degradation are severe enough to confront the world's political leaders and their constituencies. Mitigation is not sufficient: adaptation is needed as well. Investment strategies therefore need to take account of the risks that a deteriorating Earth will bring to continued human life.

The future that we as humans face is a daunting one. The Religious Society of Friends has historically taken the lead in such matters as slavery and investment, but has been slower to focus on threats to our environment and whether investments care for the planet. A preliminary review of the investment criteria of some Quaker and Quaker related funds indicates that if they include sustainability, the definition of sustainability does not make earthcare a necessary condition. It appears at an initial viewing that not many report on their ecological footprint, or how their distribution of funds contain requirements for the receiving organization or persons to measure their footprint and try and live

sustainably. Moreover, there is little coordination at an international level. If Friends worldwide are to use their money and investments, individually and collectively, in right ordering, we need to review and change where necessary the criteria for the investment and distribution of our funds. We need to work with Friends, other faith communities and other colleagues and organisations and encourage them to change their criteria also. There is much to be done, and very little time. To quote and add some questions to the Advices and Queries in the British Faith & Practice (1.02, 41 and 42)

*Try to live simply. A simple lifestyle freely chosen is a source of strength. Do not be persuaded into buying what you do not need or cannot afford. Do you keep yourself informed about the effects your style of living is having on the global economy and environment?*

*We do not own the world, and its riches are not ours to dispose of at will. Show a loving consideration for all creatures, and seek to maintain the beauty and variety of the world. Work to ensure that our increasing power over nature is used responsibly, with reverence for life. Rejoice in the splendour of God's continuing creation. How aware are you of the threats to our planet by our current economic system, and the organisations that we are dependent on for our goods and services? Are you working to change the values of human dominance, greed and arrogance that drive our exploitation and destruction of the earth? Do you search out whatever in your use of money, investments and resources that contain the seeds for destroying the planet?*

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