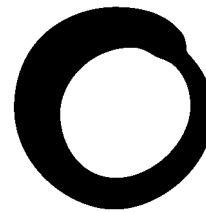


May 2003



**Friends of
the Earth**

Briefing

Investing in a better future

Ethical pensions, insurance and investments

Introduction

By investing in pensions, insurance schemes and other products we hope to secure a stable, safe future for ourselves and our families. However, these funds may be financing companies that threaten the long-term stability of the planet.

Your pension fund could be bankrolling the destruction of rainforests in Indonesia. Your savings could be funding oil companies that campaign against cuts in greenhouse gas emissions.

By choosing ethical investment funds, we can ensure that our money is not contributing to these problems. We can also invest in funds that actively support solutions to these problems, such as renewable energy and organic farming, and put pressure on companies to improve their practices. And this needn't harm your investments.

Friends of the Earth inspires solutions to environmental problems, which make life better for people.

Friends of the Earth is:

- **the UK's most influential national environmental campaigning organisation**
- **the most extensive environmental network in the world, with almost one million supporters across five continents and over 60 national organisations worldwide**
- **a unique network of campaigning local groups, working in over 200 communities throughout England, Wales and Northern Ireland**
- **dependent on individuals for over 90 per cent of its income.**

To join or make a donation call us on 0800 581 051

Friends of the Earth, 26-28 Underwood Street, London N1 7JQ

Tel: 020 7490 1555 Fax: 020 7490 0881 Email: info@foe.co.uk Website: www.foe.co.uk

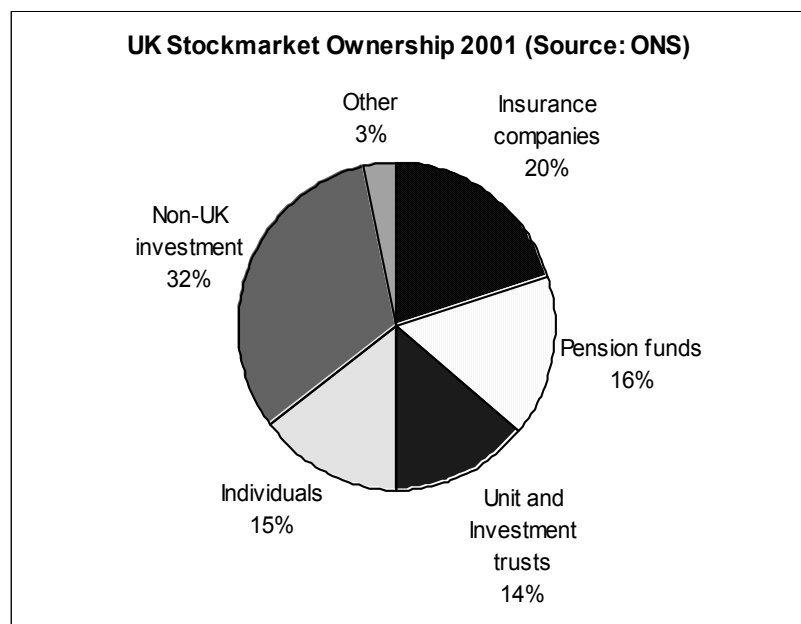
Friends of the Earth Limited company number 1012357

♻️ Printed on paper made from 100 per cent post-consumer waste

Where is your money being invested?

As investors and pension holders, our purchasing power is huge. On average, our pension funds alone are worth around £25,000 by the time we retire. Investment companies, trusts and pension funds are the largest bodies of shareholders in the country, with combined funds of around £800 billion - or 50% of the total UK stock market (see diagram). We also pay premiums to insurance companies who use that money to invest, including in the stock market, to provide money to pay for any future liabilities. So indirectly through our pension funds, insurance premiums and bank accounts we have quite a stake in the stock market. Yet unless you choose ethical or socially responsible investments then your money could be being used to fund companies that contribute to global warming, biodiversity damage and human rights abuses.

Rainforest destruction - A Friends of the Earth report, '*Paper Tiger, Hidden Dragon*', investigated links between UK financial institutions and the pulp & paper company Asia Pulp & Paper (APP) who are logging Indonesian rainforests. The pulp & paper industry in Indonesia have been responsible for destroying 835,000 hectares of high conservation value forests. Indonesian forests are extremely rich and diverse and contain, 17% of all birds and reptiles, 10% of flowering plants and 12% all mammals including orangutans, tigers and rhinos.



Our investigations of APP found a number of well known UK banks including Barclays, HSBC and NatWest had arranged finance for APP. There are also a small number UK institutional investors who had invested in APP. Unsustainable practices in the end contributed to the downfall of APP - high reputational risks associated with damaging practices, and the lack of a sustainable source of timber (only 8% came from plantations) were major factors. (http://www.foe.co.uk/resource/reports/paper_tiger_hidden_dragons.pdf).

Climate change and toxic pollution - Investment in damaging practices is not confined to the Asian paper industry, or to banks and pension funds. Another Friend of the Earth report, '*Capital Punishment*', investigated companies, part owned by UK insurance companies, that contributed to biodiversity damage, toxic pollution and climate change. The report concluded that all of the 14 largest UK insurance companies held shares in companies involved in these practices. To find out if your insurer was one of those, read the report on our website at www.foe.co.uk/campaigns/corporates/resource/investors.html

What is ethical investment?

The idea of an 'ethical company' can be different to different people. Typically people have a diverse view of which practices they may find unacceptable from animal welfare to pornography. Despite our own views on what ethics a company should operate under it is becoming clear that the right of individuals and companies to make a profit needs to be balanced more fairly with our shared values such as community, fairness, and a clean and healthy environment.

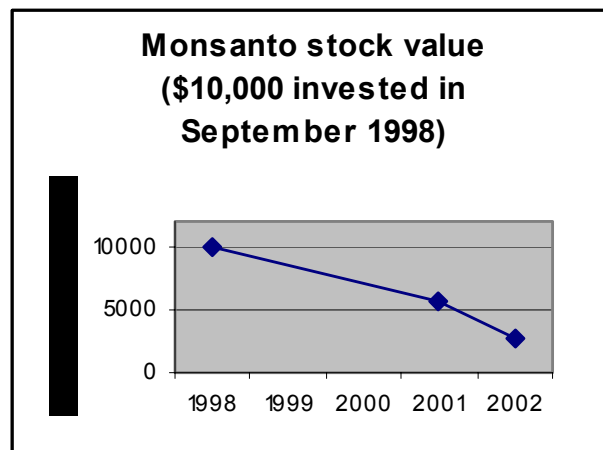
Opinion polls show that the UK public want to see improvements in business practices. The millennium poll on corporate social responsibility found that two out of three people in the UK think that companies should be responsible to *all* of their stakeholders – including employees, host communities, the environment and society as a whole - not just their shareholders. A survey in 2001 by institutional investors Friends, Ivory Sime (now ISIS) found that three quarters of UK pension holders want their funds to be used to encourage socially responsible behaviour by companies.

Many companies argue that their sole obligation is to maximise share value, and that any other considerations, such as environmental and social responsibilities, would compromise that aim. However, there is growing evidence that companies that ignore the expectations of wider society do so at their peril (see Monsanto Case Study below).

CASE STUDY: GM disaster – the danger of ignoring ethical concerns

Monsanto's introduction of Genetically Modified (GM) soya into the EU illustrates how failing to address public concerns can have dire consequences for business.

When Monsanto's GM soya went on sale in the EU, the public, environmental organisations and consumer groups were outraged that legitimate concerns over safety and contamination were ignored. Friends of the Earth campaigned strongly against the products and especially plans to mix GM and non-GM seeds which would effectively have given the public no choice.



To overcome public concerns Monsanto spent £1million on a PR campaign, without first carrying out independent safety tests. When this failed, the company's reputation was in tatters. In 1999 Europe's largest bank, Deutsche Bank, advised investors to sell their shares in Monsanto and similar companies, saying that "growing negative sentiment" was causing problems for the industry. Between 1998 and 2002 Monsanto's share value dropped by 75%. (See graph).

Investing in a Better Future

Friends of the Earth believes that companies that move now to embrace an environmental, social and ethical agenda will be the market leaders of the 21st Century. You can read more about our views on sustainable companies in the FOE report, Principles for Profit, www.foe.co.uk/campaigns/corporates/resource/investors.html

A socially responsible approach

Friends of the Earth believe that companies should place environmental sustainability and social justice at the heart of their business. Friends of the Earth's vision of a socially responsible approach to business focuses on three key areas:

- **Eco-innovation** - Companies should deliver radical improvements in efficiency in the use of the Earth's resources.
- **Social accountability** - Companies should respond to the needs of all stakeholders, including consumers, employees and communities - not just shareholders.
- **Political responsibility** - Companies should use their political influence in the interest of all stakeholders, by supporting rather than opposing international environmental agreements such as the Kyoto treaty.

Ethical approaches

Ethical investment is not a new idea. In the UK, the first ethical funds were run by the Quakers and Methodists who were concerned about issues such as temperance and employment conditions. The anti-apartheid campaign in the early 1980's broadened the appeal, leading to the creation of the first UK ethical unit trust in 1984.

“Ethical funds have increased from £200 million in 1989 to £4 billion in 2001”

Today there are a number of approaches to ethical investment to suit every need, and ethical funds continue to grow. There are over 60 SRI unit trusts in the UK, and the value of funds has increased from £200 million in 1989 to around £4 billion in 2001 (Source: EIRIS).

However, this still represents a small proportion of total investments.

The traditional (or 'ethical') investment funds invested solely in companies that were not involved in unethical practices, according to set criteria. This approach is generally known as 'screening'. Much of the recent growth in ethical funds is a result of a new strategy based on engagement, termed Socially Responsible Investment (SRI). A description of the different approaches follows.

Ethical Investment

The traditional ethical funds invest only in companies that are not involved in unethical practices, according to set criteria. The simplicity of this approach ensures that your money will only be invested in companies with ethical practices. However by excluding large numbers of companies the performance of the funds may be affected, at least in the short term. This is less relevant for pension funds which tend to invest for the long term.

Negative Screening

This is probably the most well known and oldest type of ethical investment strategy. Negative screening involves screening out all companies involved in unethical practices, according to a fund's criteria. Although these criteria may differ between funds, typically it may include:

- Alcohol production or sale
- Animal testing
- Armaments
- Environmental damage
- Gambling
- Nuclear power
- Oppressive regimes
- Pornography
- Tobacco production or sale

Funds range from 'dark green', which filter out a large number of stocks, to 'light green' with relatively few restrictions.

Positive Screening

The negative screening approach of ethical funds gave rise to the idea of positive screening, which involves highlighting companies that work towards sustainable solutions, such as renewable energy companies, environmental reporting and sustainable forestry, and actively investing in them. Using this approach, your investments may contribute to global solutions, rather than problems. As with negative screening, criteria may differ, but could include:

- Community involvement
- Employee welfare
- Environmental management
- Environmental policy
- Environmental products
- Environmental reporting
- Packaging reduction
- Sustainable forestry

'Best in class'

Another approach involves investing in those companies with the best practices, even in difficult sectors. The financial influence of the fund is used to reward improvements in company practices, such as an oil company investing heavily in renewable energy.

Socially Responsible Investment (SRI)

More recent approaches to ethical investment aim to encourage and support improvements

Investing in a Better Future

in company practices through engagement. This is similar to mainstream institutional investors who use engagement as part of their strategy to influence company decision making. Generally SRI funds may hold investments in companies involved in unethical practices, but use their influence to promote change in corporate issues such as environmental impacts, employment conditions and human rights.

SRI funds have been largely responsible for the recent rapid growth in ethical investment. Although some people question just how ethical some of these funds are. Many do not disclose which companies they invest in nor report back on how effective their strategies have been in influencing company behaviour in terms of environmental and social impacts. These issues of transparency and accountability are important matters for the future of SRI.

Engagement

Fund managers can use their influence as shareholders to put pressure on companies to improve their practices. The strength of this approach is that by being actively engaged as shareholders (including in companies involved in damaging practices), these funds have a greater influence over companies than if they didn't hold investments. Fund managers can engage with companies using their influence in a range of ways.

There are a number of actions available to fund managers to increase pressure on companies they hold a significant share in. These actions tend to reflect how successful they are at influencing companies but include scheduling meetings with the companies, voting against the company at annual general meetings and abstaining or supporting shareholder resolutions against the company.

Shareholder resolution – Balfour Beatty

Friends of the Earth bought shares and filed a shareholder resolution against Balfour Beatty, a UK construction company, who were planning to help build a controversial dam (Ilusi Dam) in Turkey that would flood an old biblical town, displace over 78,000 people and threaten ongoing disputes over access to water between Turkey's neighbours Syria and Iraq. The resolution didn't specifically call on the company to not build the Dam but instead highlighted the reputational and other business risks to the company if they proceeded. The resolution called on the company to adopt 'World Commission on Dams' guidelines so as to better manage the risk to its business from such projects. A large number of institutional investors abstained from supporting the company against the resolution and as a result Balfour Beatty later withdrew from the project and appointed a director responsible for the environment, health & safety (http://www.foe.co.uk/resource/briefings/balfour_beatty_w_c_dams.pdf).

Funds which take some active interest in social responsibility now account for more than 10% of the UK stock market - a figure that is rising (source: Association of British Insurers). Yet while ethical funds make up only a small part of the stock market their impact on large companies is limited. What is needed is for mainstream fund managers to apply ethical type investment strategies across all their funds under management in order to maximise investor pressure for good. The case of Monsanto and GMO's illustrated earlier along with recent corporate scandals involving Enron and WorldComm show just how important the benefits can be of applying ethical investment criteria when screening or engaging companies.

Ethical products

The range of ethical investment products available today is greater than ever. According to the Which? Way to Invest and Save guide, 'personal pensions, mortgage endowments, unit trusts, life insurance, critical illness protection and general insurance can all be set up through funds that pursue ethical policies.'

Ethical investment products that are available:

- Savings - unit trusts investing in the UK or global markets, ISA's
- Pensions - occupational pensions, personal pensions, stakeholder pensions
- Insurance - life assurance, general insurance, Individual Savings Accounts (ISA)
- Mortgages - endowment policies and mortgages for environmental projects
- Bank accounts - specialist banks lending to businesses building a sustainable future

Performance of ethical investments

Investment in the stock market is always a gamble. 'Quick buck' business ventures such as the paper industry in Indonesia can profit from environmental destruction, but also carry high financial risks. By choosing responsible alternatives you can avoid environmental and social risks, and promote greater financial – as well as environmental – sustainability.

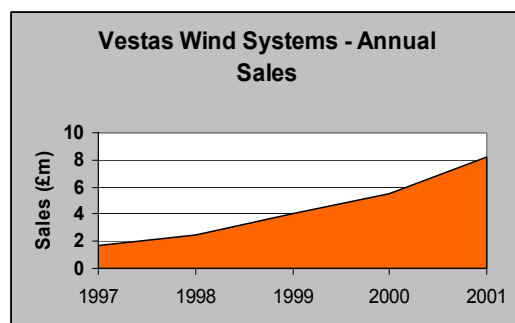
Over the short term, ethical funds may be affected by a number of factors. They tend to have more small companies in their portfolios (as large, umbrella companies with only ethical practices are harder to find), and invest more in new technologies. These companies can be in or out of favour with mainstream investors, which can sometimes work in your favour and sometimes against.

SRI funds tend to have a broader range of companies in their portfolio, so are less likely to be affected by trends in these narrow sectors. SRI funds may outperform their ethical equivalents. Both ethical and socially responsible investments can benefit from business opportunities in environmental solutions (see Vestas case study below).

CASE STUDY: Wind power – ethical investments doesn't mean lower returns

With growing market acceptance of long-term environmental problems such as global climate change, companies working towards environmental solutions represent excellent investment opportunities.

Vestas is the world's leading wind turbine manufacturer, and their work is at the cutting edge of technological innovation. The company provided turbines for the UK's first offshore wind plant at Blyth, which produces enough power for 3,000 homes.



Investing in a Better Future

Vestas has benefited from government measures aimed at increasing renewable energy production and mainstream investor interest, and the whole industry has seen big rises in demand. Sales at Vestas, the world's leading wind turbine manufacturer, have increased five-fold over the last six years (see graph).

According to the ethical investment guide published by the Investment Management Association, over the longer term:

“ethical funds have performed much on a par with their non-ethical equivalents. Investing ethically does not mean that you have to sacrifice financial performance”.

A recent study carried out by Sarasin Bank and the Centre for European Economic Research (ZEW) found that sustainable funds have generally performed at least as well as conventional funds. The study also found that environment-friendly sectors showed a significant performance advantage, and lower risk of share price fluctuations.

The business case for socially responsible investment

There is in fact a good business argument for socially responsible investment. A report by the Association of British Insurers argued that companies with good ethical conduct could expect a two-fold advantage.

1. Lower risks, lower costs

The report identified a clear risk to shareholder value from failing to meet society's expectations in areas such as employment conditions, human rights and environmental management. Investors want to see that these risks are well managed, and will put pressure on companies with poor practices. Ultimately, higher risks will lead to higher capital costs.

2. Competitive advantage

The report found growing evidence that an ethical approach would translate into a competitive advantage in a number of ways, including increased income, lower share price volatility, increased stakeholder loyalty, attracting talented employees, and more supportive communities.

Ethical investment in the UK

In 1999, the Pension Minister Stephen Timms was quoted as saying, “ordinary people want to know what is being done with the money invested on their behalf”.

Subsequently the Pension Act 1995 was amended in July 2000 so that trustees of occupational pension funds were required to state the *“extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments”*.

Every occupational pension scheme should now explain how they handle social, ethical and environmental considerations in the Statement of Investment Principles (SIP) provided by

fund administrators. You should find this in your annual pension fund report.

Friends of the Earth surveyed the largest 100 occupational pension funds following this change in legislation. The results of this survey were published in the report, Top 100 UK pension funds - how ethical are they?

The good news was that there had been an encouraging response to the change. Ninety percent of the occupational pensions that responded in the survey did indeed refer to ethics or corporate social responsibility in their investment principles.

However, many funds had few or no accountability mechanisms to ensure that these principles would be taken into account when making investment decisions, making the amendment effectively toothless. Many statements were also vague and ambiguous (http://www.foe.co.uk/resource/briefings/top_100_uk_pension_funds.pdf).

The Just Pensions Group, managed by War on Want and Traidcraft, carried out a similar survey. The most recent update of this report, Do UK Pension Funds Invest Responsibly?, was issued in July 2002. It had familiar conclusions, saying that “most pension funds’ reluctance or inability to monitor the activities of their investment managers in assessing social, environmental and ethical investment issues is one of the most disturbing findings of this report” (www.justpensions.org/ukpf2002-justpens.pdf).

Friends of the Earth’s campaigns

Friends of the Earth welcomes the new pension disclosure requirements in the amendment to the Pensions Act 1995, and believe that encouraging developments have taken place since then. However, we have now had more than two years for pension funds to adopt new policies and practices and what is clear is that a lot still needs to be done to enable ethical investment to grow. Friends of the Earth believes that critical developments should include:

- **Better implementation mechanisms** - To ensure that ethical, social and environmental objectives in funds’ investment principles are actually being met, and regularly reported and enforced.
- **More explicit policies in engagement** - Measures such as guidance for reporting on socially responsible investment, and introducing agreed targets and sanctions to involve companies, fund members and stakeholders.
- **Better disclosure of ethical policy and investments** - This could include publishing policies on SRI issues with their current shareholdings, for instance on a fund website.
- **Allocate more resources** - Funds should increase resources to be able to research, engage, monitor and report on SRI issues.
- **Establish an ongoing consultation with the funds’ beneficiaries** - There needs to be an appropriate forum for members to discuss their concerns and report back to the trustees.

Friends of the Earth believes that companies have a vital but unfulfilled role to play in resolving social and environmental challenges. To this end, Friends of the Earth campaigns for changes in UK environmental laws and taxes, stronger international agreements and

Investing in a Better Future

improvements in company practices.

Ethical funds play a vital role in bringing about changes in corporate practice. Friends of the Earth believes that ethical funds must be urgently expanded, and is seeking to convince the large City institutions to adopt ethical and environmental criteria for all their investment decisions, not just those related to ethical funds.

In reality, companies often listen to shareholders more than NGO's. Shareholders have a lot of financial muscle that could be used to accelerate changes in practice, and the more people choosing to invest in ethical funds, the greater the pressure on institutions to change their investment practices.

What can you do?

Write to your pension fund or bank and ask if

- they take into account ethical, social or environmental matters when determining their investments and if so,
- can they provide information as to how this affected their investment decision making and evidence of any changes in companies they engaged on such matters.

Write to the Government and ask them to

- amend the Pensions Act so that pension funds have to *demonstrate how they are meeting their obligations* under any social, ethical or environmental investment criteria by reporting annually on the implementation of such policies. If you want to do more then write to your MP and ask them to sign Early Day Motion 524 which endorses the above demand.
- extend pensions disclosure on social, ethical and environmental criteria to other areas of investment including banking and insurance.

Further information

General advice

When making a long-term financial decision it is best to seek some professional advice. Any authorised Independent Financial Adviser can give advice on ethical investments, although you may wish to approach a firm that specialises in this area. **Do not alter your present financial arrangements without first seeking professional guidance.**

Financial advice

For a list of Independent Financial Advisors who specialise in ethical investment then you can contact the Ethical Investment Association, UK Social Investment Forum or EIRIS.

Ethical Investment Association

Web: www.ethicalinvestment.org.uk

The Ethical Investment Association (EIA) is a nationwide body of independent financial advisers (IFAs), which aims to facilitate the promotion of ethical investment by its members, and to set standards in the ethical investment industry. Members agree to abide by a code of conduct and to engage in a continued programme of training and development in the field of ethical investment.

UK Social Investment Forum

Unit 203, Hatton Square Business Centre, 16/16a Baldwins Gardens, London EC1N 7RJ

Tel: 020 7405 0040 Fax: 020 7405 0080

Web: www.uksif.org

The UK Social Investment Forum's primary purpose is to promote and encourage the development and positive impact of Socially Responsible Investment throughout the UK.

Ethical Investment Research & Information Service (EIRIS)

80-84 Bondway, London SW8 1SF

Tel: Tel: 020 7840 5700

Website: www.eiris.org

Provides independent research on companies for ethical investors.

Information on companies

Ethical Consumer Research Association

Unit 21, 41 Old Birley Street, Manchester M15 5RF

Tel: 0161 226 2929

Website: www.ethicalconsumer.org

Produces Ethical Consumer Magazine and Corporate Critic Online Database - an essential tool for checking the ethical and environmental performance of companies.

Corporate Watch

16b Cherwell Street, Oxford, OX4 1BG Tel:01865 791 391 Fax: 01865 243 562

Web: <http://www.corporatewatch.org>

E-mail: mail@corporatewatch.org

Publishes DIY guide on how to research companies.

Multinational Monitor

PO Box 19405, Washington, DC 20036 USA. Tel: +1 (202) 387-8030.

Web: www.essential.org/monitor/monitor.html

E-mail: monitor@essential.org

Tracks corporate activity, especially in the Third World, focussing on the export of hazardous substances, worker health and safety, labour union issues and the environment.