Ethical Investing: Who, Why and How?

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JBWere

Ethical questions are an inescapable part of being human. We ask ethical questions whenever we think about how we should act. Being ethical is a part of what defines us as human beings. We are rational, thinking, choosing creatures. – The Ethics Centre

JBWere is the leading provider of investment management services to for-purpose entities and individuals and families across Australia and New Zealand. Like society in general, our clients' ethics are wide ranging – influenced by their faith, social beliefs, life experiences and individual/family values.

Part of our unique role is to educate and guide our clients as they determine if, why and how they should invest to align their investment approach with their values. We are deeply committed to guiding our clients through these important decisions – in 2017 JBWere became the first private wealth manager in Australia to develop a coherent and considered Social Responsible Investment (SRI) framework for the benefit of our clients. More on this can be found by visiting jbwere.com.au

There are three core pillars in our approach to SRI:

- Screening based on Ethical, Moral or Religious beliefs (Ethical Investing)
- Integration of Environmental, Social and Governance (ESG) factors; and
- Impact Investment.

Socially Responsible Investing – The JBWere Approach

Diagram 1: Socially Responsible Investing – the JBWere Approach

The Responsible Investment Benchmark Report 2018 reinforces the fact that the responsible investment industry is continuing its upward trajectory and now makes up the majority of the overall investment market in Australia.

The research reveals it consists of $866 billion of assets, *or **55.5% of all assets professionally managed** in this country in 2017.* Core responsible investment (primarily ethical) funds grew significantly, increasing by 188% to $186.7 billion, or 11% of all assets.

Responsible Investment Association Australasia (RIAA) Report (2018)

Although there has been significant growth and mainstreaming in recent years, incorporating ethics into investments is not a new doctrine. Living in an increasingly global world raises ethical issues for individuals, communities, for-purpose organisations corporations and nation states. Self-determination, family values, vested interests, nationality, political correctness, faith, social media, activism, populism and ideology can all add complexity to the lens through which we view ethical issues. With that lens comes questions around what is the 'right' ethical approach, and quite often, there may be more than one approach.

This paper explores ethical investing by addressing the following questions:

- **Who** should engage in ethical investment?
- **Why** should ethical investment be undertaken and how can it be implemented?
- **How** to do it – Is it a purely values based decision and/or are you trying to create change and if so what change and how will this be achieved?

With differing options, brings important decisions around cause and effect. Before incorporating ethics into your investment approach, it is important to seek clarity around what you are trying to achieve.

Where it all started – Ethics and Investments

> "The love of money," we know, "is the root of all evil;" but not the thing itself. The fault does not lie in the money, but in them that use it. It may be used ill; And what may not? But it may likewise be used well: It is full as applicable to the best, as to the worst uses." - **John Wesley**

It is poignant to note that the pioneers of ethical investment came from the diverse faiths of the Quakers movement, Methodists and the Quran.

- *In 1758, the Quaker Philadelphia Yearly Meeting prohibited members from participating in the slave trade: buying or selling humans.*[1]
- *John Wesley's sermon "The Use of Money" outlined his basic tenets of social investing i.e. not to harm your neighbour through your business practices and to avoid industries like tanning and chemical production, which can harm the health of workers.*[2]
- *Among the principle pillars of an Islamic society are love and fear of God, honesty, and justice (Note 5). Islamic finance flows from the principle that religion cannot be divorced from any aspect of life, including business.*[3]

And although those of faith have generally applied ethical filters for centuries, what we are witnessing is a mainstreaming of ethical considerations across corporations, financial markets and society. Many investors are grappling with how they align their investment choices with their values and what impact those value decisions could have on challenges like health, inequality, climate change and human rights.

We'll see more people wanting to pursue a life that is more immediately connected with what they care about, with their values, their vision, and this gives them an opportunity to basically operate on a more integrated and holistic basis as opposed to somehow thinking that how they invest is disconnected from their community, from the things that they care about. - **Jed Emerson**[4]

Who should engage in ethical investing?

Individuals & Families

Most people define what is 'ethical' based on the values and standards established within their family and upbringing.

Family values include the qualities that are most important to you as a family, such as integrity or hard work or kindness; they also define what you believe is right and wrong. Your family's moral definitions might shape, for example, what you consider acceptable for public conduct, work ethic, and social views.[5]

However, we all have other sets of influencers that help each of us, as individuals, define what we believe to be right and wrong, be it friends, work, community, faith, for-purpose organisations or others.

Key questions for Individual investors and their families regarding ethical investment:

1. Have you and/or family had an ethical or values conversation? Does your faith or other factors help define your ethics?
2. Should your values align with your investments? If yes, should you have an ethical investment mandate?
3. Are there certain industries or companies that you are not willing to invest in?
4. What are your views on these companies and their respective Industry types? (e.g. with Tobacco, do you only care about Tobacco production or Tobacco retailing as well?)
5. If you were to exclude Companies or an Industry, would it be based on the companies' involvement and/or revenue or other factors?
6. Alternatively or additionally, do you want to target specific industries from a more positive thematic perspective?
7. Do you wish for the ethical investment mandate to apply to all of your investments or even extending to purchasing of goods and services? If yes, then which structures (e.g. private investments, SMSF, Family Trust or Private Ancillary Funds)?

Fiduciaries and Ethics

The governing body of a Charity is the group of individuals who together are ultimately responsible for overseeing its operations and making sure it is working towards achieving its charitable purpose. The board members should help your charity to stay focused on its objectives, manage its finances effectively and comply with the legal, operational and ethical requirements of your charity.[6]

The culture of an organisation could be thought of as its "personality". It is represented by shared values, norms, practices and core beliefs that shape behaviour. Organisational culture is sometimes described as "how we do things around here". The culture of an organisation therefore influences what it does, its relationships with stakeholders and its reputation. It can also be an important determinant of whether the organisation is able to achieve its strategic objectives and deliver on its purpose. It is widely recognised that the culture of an organisation will be influenced by the conduct and actions of the board and individual directors.[7]

Separating personal ethics and organisational ethics

Fiduciaries cannot and should not serve their own interests; every decision they make must be impartial and in the best interests of the organisation they serve. In making decisions fiduciaries must consider their organisations mission, their often diverse group of stakeholders and global norms within their decision-making.

For-purpose organisations are essentially companies/businesses that seek to deliver lasting social outcomes. Hence, as part of their processes, like any entity of significant size, they should conduct corporate materiality analyses. This involves identifying critical economic, environmental and social issues which may either have a significant impact on the company's business performance or substantively influence the assessments and decisions of its stakeholders. Importantly, such analyses should also determine key risks to the business, stakeholders and in particular, the mission and beneficiaries.

Specifically in regards to ethical investment, fiduciaries should be able to identify the ethical issues and related industries that may contradict with their organisation's mission, contradict public policy or negatively affect beneficiaries. Given the mainstreaming of SRI, it can be expected that certain exclusions will become new norms over time, often based on the primary cause area that a charity fits within (e.g. a charity engaged in health research may wish to exclude anything tied to damaging health outcomes, such as Tobacco).

Issue and industry type materiality analyses can be just as applicable to determining which type of corporations for-purpose organisations will accept funding from or enter into partnerships with. A disconnect or misalignment with whom you will take donations from and who you will invest in creates confusion at best – and reputational damage at worst.

The table below presents an example of the type of materiality analysis a Board and Executive may conduct. Here scores are applied in a matrix to identify which activities/exposures are relevant to which stakeholders. Total scores below 0, identifies to the Board potential exposures which may be misaligned with their mission or key stakeholders.

The 2018 Edelman Trust Barometer is a global survey on institutional trust conducted by public relations firm Edelman. The barometer has registered declines in trust in all four institutional groups it covers– government, media, business and NGOs (non-government organisations). Worryingly, trust in NGOs, which had previously been the only institutional group above the critical 50% threshold, fell significantly to 48% (down 4%).

ETHICAL MATERIALITY ANALYSIS – for philanthropic capital and corporate partnerships

Business Activity or Company = X Stakeholder Group = Y	Abortion	Adult Entertainment	Alcohol	Animal Welfare	Gambling	Tobacco	Weapons	Other Business Activity
Beneficiary/Client								
Philanthropic Supporters								
Corporate Funders/ Supporters								
Government Departments								
Employees								
Volunteers								
Media								
Regulators								
Service Providers (Supply Chain)								
Other								
TOTAL								

-1 = Contradicts expectations, 0 = Ambivalent, 1 = Alignment

Why engage in ethical investing? Differing approaches

We are currently witnessing the rapid development and an evolution in ethical investing. However, before you decide on being an ethical investor, you should consider the rationale of why it is important to you. Answering why ethical investing matters to you will definitely help you answer how you should apply an ethical lens. Below we explore three differing approaches to how ethical investment can be implemented as an ethical investor.

Approach 1: Uninvest based on values

Firstly, any ethical investment should be a rational decision based on ethics and values, be they personal for individuals and families, or mission and beneficiary related for Fiduciaries. The question you should answer is: what issues, companies or industries are fundamentally misaligned with your values or those of your beneficiaries? This is primarily done through **negative screening**. A broad list of ethical exclusions often leads to a direct investment approach across asset classes.

However, it is important for private investors and fiduciaries to note that an overly exclusionary approach can dramatically reduce the investable universe and add financial and concentration risk to an investment portfolio. Coming to an agreement with multiple fiduciaries can be hard, but stakeholder analysis, feedback, pragmatism and access to reliable data will be the key.

So in essence you undertake ethical investment to ensure your investments reflect your values. This decision will be based on either personally living life with certain principles or faith. For example, an individual of the Catholic faith may be opposed to investment in companies with exposure to stem cell research. Alternatively, this decision may arise as a result of fiduciaries noting that a material conflict that contradicts stakeholder expectations between a certain business activity or industry and the for-purpose organisation, for example a cancer research charity and tobacco production.

Values decisions are primarily made with the belief that it is the right or necessary thing to do. By making this decision, you elect to not invest or uninvest from an existing investment in certain companies or industries through the use of an ethical screen to exclude undesired investments. Even though the pool of global capital may be finite, you should make this values decision with the knowledge and expectation that your action is unlikely to make any immediate or discernible difference to the Company or Industry that you are excluding. Uninvesting is not likely to be noticeable if it does not create stigma or have a material impact on the market of those securities.

Alternatively, rather than just excluding an industry, you may also decide to positively invest by implementing a **positive screen** on companies or industry types that you see as actively contributing towards your values or through consideration of positive thematics such as investing in renewables or water companies. Some view this as a risk mitigation strategy to address potential future environmental challenges.

Approach 2: Divestment

The second approach is divestment. The term divestment is often used when a client 'uninvests'. However, divestment is the terminology that has been used in social and environmental movements and implies a sense of responsibility to advance change. In short, divestment is about bringing the weight of your voice to the act of uninvesting.

Divestment as a movement is believed to have first begun at scale in the early 1980's when students in colleges across the U.S. demanded that their universities stop investing in companies that conducted business in South Africa to protest the apartheid system. As an example of social activism, the South African apartheid campaign in the 1980's was very successful. By the end of the decade, about a hundred and fifty educational Institutions had divested and subsequently, as history shows, Apartheid ended in 1990.

However, an important study regarding the impact of the divestment campaign on the South African financial market and the share prices of U.S. companies with South African operations concluded that the Apartheid Divestment campaign had no discernible effect on the share market valuations – effectively because 'other' investors bought the shares that the 'ethical' investors divested[8]. Nevertheless it helped highlight the issue which may lead to the desired change. Current examples of significant divestment movements relate to tobacco and fossil fuels.

Based on our analysis, we believe divestment can create change in company value by posing additional long term risk, through stigma, which can add uncertainty in regards to regulatory change and reputational issues. By extension this may affect future cash flows and the intrinsic value of a company.

That said, the more important element of divestment is that it is about being able to articulate and communicate your values and ethics in an open and transparent manner. For Fiduciaries, this is critical to understand when many stakeholders are involved.

See appendix A for further analysis around divestment, risk and intrinsic value.

> **"Divestment is about bringing the weight of your voice to the act of uninvesting."**

Approach 3: Engagement

Bill McNabb, chief executive of Vanguard, whose company manages $3.5tn in assets, expressed scepticism that divestment would affect share prices enough to register inside the boardroom. "There is no impact to the income or balance sheet of the company. You are not sending a message to the company. You are better remaining an owner and being able to engage with the company."

A growing number of institutional investors are undertaking corporate engagement and exercising their rights as shareholders to influence corporate behaviour. Engagement and voting activities are often referred to as stewardship.

To date, rather than **Ethical investing** direct institutional investor engagement has been primarily focused on managing **environmental, social and governance (ESG)** risks and has become increasingly prevalent in financial markets worldwide. Several factors are contributing to this engagement trend, including increased asset manager adaption, public interest in corporate social responsibility (CSR) and the growing size and importance of institutional shareholdings. Between 2014 and 2016, the volume of assets managed with explicit commitments to engage or vote on ESG issues grew 41% (GSIA, 2016).[9]

Two important studies have shown that Investors' engagement can help protect long-term investment value.

Analysis of 2,152 engagement exercises with 613 public firms between 1999 and 2009 offers, thus far, the most convincing empirical results that successful ESG engagement leads to cumulative size-adjusted abnormal returns over the years following the initial engagement.[10]

Dimson, Karakas and Li (2015) examine the highly intensive environmental, social and governance corporate engagement activities at 613 US firms between 1999 and 2009 (the sample consists of a total of 2,152 engagement sequences). The findings reveal that ESG engagements generate a cumulative size-adjusted abnormal return of 2.3% over the year following initial engagement. Successful engagements, where the institutional investor achieved change, generate much higher cumulative abnormal returns of +7.1%.

The research provides evidence that ESG engagement activities can be value enhancing for shareholders as the targeted firms' operating performance, profitability, efficiency and governance indices improve as a result of successful engagements.[11]

Some investors may choose to continue holding fossil fuel companies and use their voice as shareholders to effect change, as noted on page 11 of the actions of the Action 100+ paper. Institutional investors are well placed to engage with and influence companies, especially if multiple investors are engaging on a similar issue. However questions need to be raised around capability and ability – such as whether retail or wholesale investors have the ability to create change through engagement alone.

We do also need to differentiate ethical values from ESG risks. It is important here to note that ESG integration is about how effectively a company is being managed in the broadest sense and not a 'values' based ethical judgment on the nature of the activities that it undertakes. Diversification across product lines or multiple revenue streams within corporations may well be the best determinant of whether engagement on an ethical issue (compared to ESG) is likely to change corporate behaviour. As demonstrated by Tobacco divestment, most producers' revenue has not been affected due to companies tilting their operations to developing/emerging markets. Engagement with a Tobacco company around changing their core business is unlikely to create change while engagement on factors concerning the environmental impact of growing tobacco and the rights of farmers has been shown to engender change. This is seen in the case of British American Tobacco (BAT), which has an MSCI ESG Rating of AA and is credited for its above average efforts in minimizing 'biodiversity issues associated with growing tobacco', which included 'sponsoring afforestation programs in Sabah, Malaysia to restore land disturbed by its tobacco plantation activities'.

An example of a diversified energy company is AGL.

"As the country's largest electricity generator, AGL is in a unique position we are both the largest ASX-listed investor in renewables, but we have the largest carbon footprint, and we cannot afford to approach the climate change debate with an ideological perspective. Our investors, many of whom are ordinary Australians that own AGL through their superannuation, want us to be planning for the future." - AGL ex CEO Andy Vesey

Studies have shown that Institutional engagement around ESG risks delivers change within companies as well as long term drivers of value and financial returns. Contrastingly, engagement on specific ethical issues, especially by retail investors has not engendered or been rewarded through strategic change. In short, engagement is generally not an avenue available to many investors – driving long term change may be limited to divestment.

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How do you implement ethical investing?

Negative screening continues to be the most popular strategy used to undertake Ethical Investment in Australia.

The use of screening has seen a significant amount of growth, year on year, with AUM increasing by 340% in 2016. Historically this category related primarily to ethical or socially responsible investment funds and trusts. Currently, a significant contribution to this category comes from large asset managers through funds and institutional mandates.[12]

At JBWere, our implementation of the ethical investing pillar of our integrated SRI framework is facilitated through our partnership with MSCI ESG Research, the leading provider of global Ethical and ESG Research. MSCI (Ethical) Business Involvement Screening Research (BISR) provides information on companies' involvement (including revenue exposures) in a variety of business activities, including:

- Abortion Providers
- Abortifacients
- Adult Entertainment
- Alcohol
- Animal Welfare
- Biological / Chemical Weapons Systems
- Breast Milk Substitutes
- Carbon and Fossil Fuel
- Contraceptives
- Controversial weapons
- Conventional weapons
- Defense and Weapons
- Firearms
- For Profit Healthcare
- Fur
- Gambling
- Genetic Engineering
- Lending Practices
- Nuclear Power
- Pork
- Stem Cells
- Tobacco

A key consideration across any ethical screen is the classification of a Company's involvement, be it Direct, Semi-Direct and Indirect and/or revenue based.

MSCI Ties:

MSCI Ties:

Direct		Semi – direct						Indirect	
Producer	Operator	Retailer	Distributor	Supplier	Support	Services	Licensor	Ownership	Ownership Of

Materiality and Governance

The majority of for-purpose boards recognise that having an Investment Policy Statement (IPS) which incorporates their position on Ethical investment and ESG is best practice investment governance.

In our experience with for-purpose organisations specifically, ethical investing is implemented through ethical exclusions stipulated in IPS' for both direct and managed investments. These typically prohibit certain industry ties and/or specify revenue threshold, i.e. the percentage of revenue a firm derives from business activities within a prohibited industry before investment in that company is precluded. These organisations may also wish to distinguish between the type of involvement a company has in a certain industry (i.e. Direct, semi-direct or indirect).

For example, according to MSCI BISR and as at August 2018, Woolworths Group Limited derives 14.99% of its revenue from alcohol generally and only as a retailer. An organisation stipulating a threshold of 10% for the alcohol industry in general may prohibit the inclusion of Woolworths into their portfolio while another organisation stipulating a threshold of 10% for alcohol production will not be opposed to investment in Woolworths.

The right approach will be determined by what the client seeks – but whichever approach is utilised we strongly suggest the incorporation of such wording in IPS' (investment governance framework), investment mandate guidelines (Statements of Advice) for private clients and Self Managed Super Fund investment strategies.

It is important to note that most ethical funds' exclusions are not onerous and normally only remove industries from a production or operator level. The most common ethical exclusions include:

- Alcohol production
- Tobacco production
- Gaming– support and operations
- Weapons
- Adult Entertainment

Direct or Managed Funds

Leveraging our partnership with MSCI ESG Research, we are able to access granular details on individual companies' activities, revenue sources and the percentage of a fund's holdings in companies involved in controversial industries. This allows JBWere to have the capability to model the likely amount of securities or funds that would be excluded by the ethical considerations of individuals, families or for-purpose organisations. This ultimately allows JBWere to effectively advise on and manage clients' ethical investing mandates. The JBWere Philanthropic Services team have significant experience and skill in creating and evolving governance frameworks and policy documents with an ethical investing focus.

We take our commitment to ensuring our clients are able to implement their ethical exclusions regardless of approach – as such we insist on a look through to all of the underlying holdings of all the managed funds on our high conviction list to make sure the managers we select are true to brand and meet our clients' needs. We also have significant knowledge and access to ethical passive strategies as the market matures.

Concluding Comments

Ethical investment as part of the Social Responsible Investment suite is becoming more mainstream. As the investment markets, economies and societies evolve, values based investing has moved beyond being the unique domain of the religious, it is now a key consideration for investors of all stripes.

As the leading provider of strategic and governance advice to individuals, families and organisations driven by purpose, JBWere is uniquely positioned to guide our clients to both develop and implement portfolios which truly reflect their values.

If you would like to explore how we might assist you or your organization, please do not hesitate to contact your JBWere advisor, or a member of the JBWere Philanthropic Services team on 1300 263 166.

Appendix

Appendix A – Divestment Approaches

Can Divestment challenge investors to better price risk?

Yes, however it's very likely to be dependent on your financial analysis and investment timeframe.

As the Bank of England's Andrew Haldane has noted, short-termism seems to be getting worse: U.S. and U.K. investors tend to place a much lower value on distant cash flows than they should, with returns more than 30 years out counting essentially for nothing. This is troubling if we're expecting markets to put a price on the risk of, say, an ecological disaster unfolding over the next 50 years or century.

Because traditional financial analysis tends to focus on short-term earnings and operates within short-term benchmarks, it may be difficult to reconcile with key ESG issues that are aimed at uncovering risks in the medium to long term.[13]

Intrinsic value versus market price

Intrinsic value (a.k.a. fundamental value), is the perceived value of an investment's future cash flow, expected growth, and risk. In other words, intrinsic value is the future cash flow discounted back to a present value. Understand the intrinsic value maybe significantly different from the market value or price of the investment. The market price is the price you can buy and sell the asset (i.e. a stock quote). Buyers and sellers have many different ways of measuring value and various reasons (many of them emotional) for buying and selling an asset. Mr. Market is very fickle.[14]

Divestment creates long term risk uncertainty. If this risk is not priced in by the market or cannot readily be measured, divestment could lead to companies being overvalued from an intrinsic value perspective. Alternatively, if divestment occurs when investments are already trading at a premium to their intrinsic value, incumbent investors may be faced with the prospect of earning even lower risk adjusted returns.

An additional consideration after pricing risk is whether an institutional (or mass retail mandate) divestment could materially move a company's share price. Considerations include liquidity, diversification of the share registry, and the breakdown between institutional investors and retail investors. It is unlikely that the actions of one entity, even a large institutional player, could move the market price significantly.

Investors may believe that divesting publicly listed securities of well-capitalised companies may restrict their supply of capital. However, this argument is not likely in the short term given that markets are likely to match buyers with any sellers of securities. The fact that there is a market specifically for what are commonly considered 'sin' or unethical investments is demonstrated by the fact that there is an International Securities Exchange (ISE) SINdex. The ISE SINdex tracks the performance of publicly traded companies including casinos and gambling facilities owners and operators, producers of beer and malt liquors, distillers, vintners and producers of other alcoholic beverages, and manufacturers of cigarettes and other tobacco products.

Other notable divestment campaigns have included Tobacco, Go Fossil Free and more recently guns in the US. They are all having somewhat varied immediate impacts on financial markets in comparison to their more significant impacts on stigmatisation. Divestment does however send a strong societal signal that a certain behaviour is wrong, which can be just as effective long term as financial change.

Divestment campaigns – Tobacco

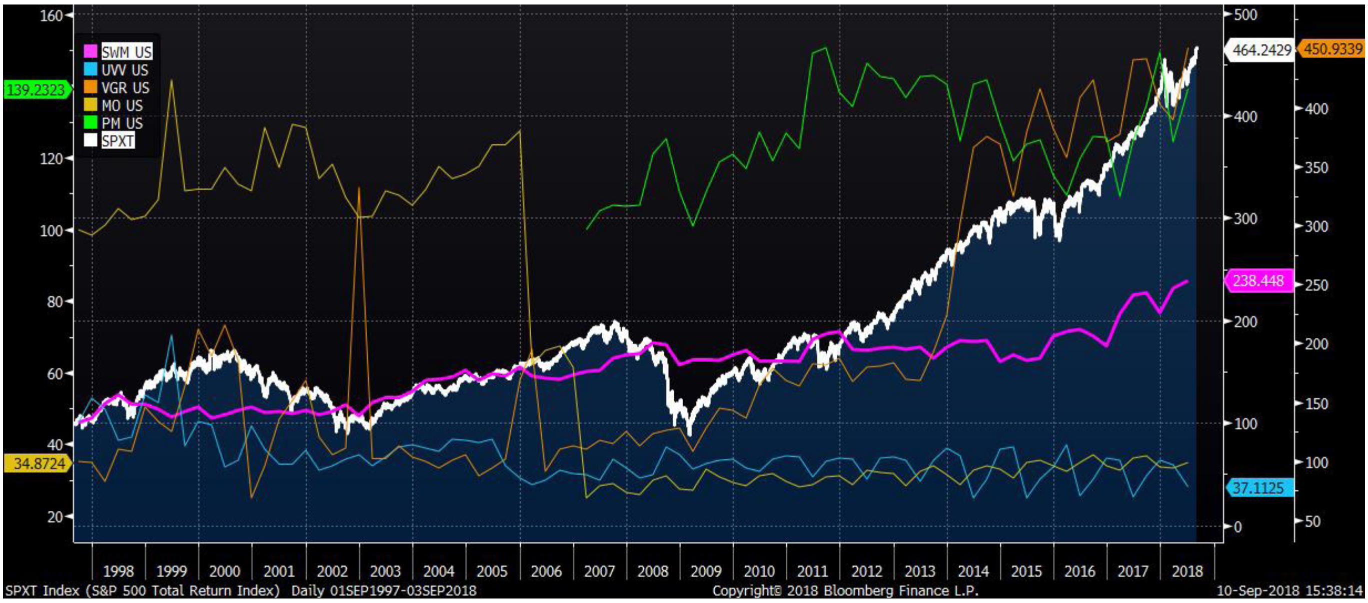
According to a Social Funds study, 'Tobacco Divestment back in 2012, only about 80 organisations and funds including religious organisations, public health organisations, universities, and public pension funds have divested from tobacco equity and even fewer from tobacco debt despite large interest in the media and over 30 years of campaigning. This comes from a universe of nearly 1,000 global funds, university endowments and organisations.

However much more recent success can be noted through the Bronwyn Kind founded Tobacco Free Portfolios, which has influenced many major global investment funds to divest all of their tobacco holdings. Some of the higher profile organisations successfully lobbied include AMP and Medibank Private in Australia, AXA in France, the Ireland Strategic Investment Fund and Sweden's largest pension fund, AP4.

In 2015, over 1.1 billion people smoked tobacco. Far more males than females smoked tobacco. Although it is declining worldwide, the prevalence of tobacco smoking appears to be increasing in the WHO Eastern Mediterranean Region and the African Region.[15]

Unfortunately for proponents of divestment, these more proactive institutional developments have had limited direct impacts on the equity markets for Tobacco producers. While smoking rates have declined in many developed countries, tobacco companies' expansion into emerging markets has still kept cash flows and revenue at strong levels. The chart below illustrates the revenue of US listed producers vs S&P 500 Total return index (white line). Most producers show that revenue has not been impacted by divestment.

Revenue of tobacco products over the past 20 years vs S&P 500 Total Return Index



Source 1: http://www.who.int/gho/tobacco/use/en/

Divestment Campaigns - Fossil Fuels

As part of its global policy, 350.org launched the 'Go Fossil Free: Divest from Fossil Fuels!' campaign. The campaign calls for colleges and universities, as well as cities, religious institutions, and pension funds, to withdraw their investments from fossil fuel companies.

The aims of the fossil fuel divestment campaign are threefold:

1. 'force the hand' of the fossil fuel companies and pressure government—e.g. via legislation—to leave the fossil fuels (oil, gas, coal) 'down there';
2. pressure fossil fuel companies to undergo 'transformative change' that can cause a drastic reduction in carbon emissions—e.g. by switching to less carbon-intensive forms of energy supply;
3. pressure governments to enact legislation such as a ban on further drilling or a carbon tax.

Since its inception in 2012, 967 institutions and local governments alongside thousands of individuals representing over $6.24tn in assets have pledged to divest from fossil fuels.

High-profile pledges to divest have included Norway's Sovereign Wealth Fund, the Episcopal church, the Church of England, Rockefeller Brothers Fund, World Council of Churches, the California Academy of Sciences, the British Medical Association, and Newcastle, Australia, home of the world's largest coal port.

Statements from the Annual Reports of major energy industry players have specifically noted that divestment does pose a material threat to their business:

Concerns about the environmental impacts of coal combustion, including perceived impacts on global climate issues, are resulting in increased regulation of coal combustion in many jurisdictions, unfavourable lending policies by government-backed lending institutions and development banks toward the financing of new overseas coal-fueled power plants and divestment efforts affecting the investment community, which could significantly affect demand for our products or our securities.[16]

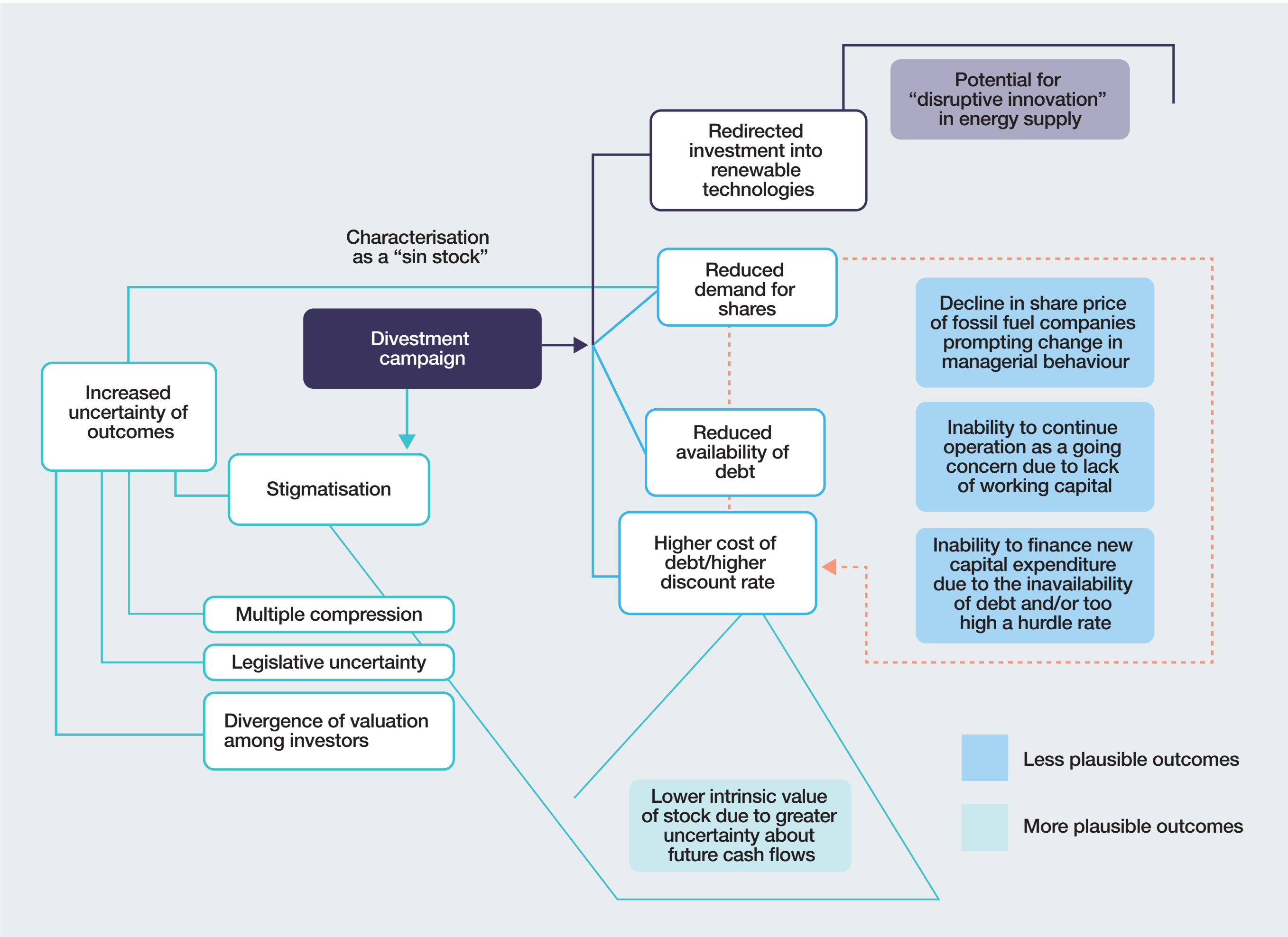
In a 2013 report by the Smith School of Enterprise and the Environment at the University of Oxford, the authors found that coal stocks are less liquid than those of oil and natural gas and that divestment therefore has a greater chance of impacting share price because it is more difficult for alternative investors to be found. In that same Oxford report, the authors cautioned campaigners that the direct impact of divestment is "likely to be minimal."

Fossil Fuel divestment would appear to be a powerful tool in driving change within the Fossil Fuel Industry, rather than an immediate means to create market risk to fossil fuel companies. With the global transition towards low carbon economies, one of the medium to longer term risks is that of stranded assets. More diversified Fossil Fuel companies would appear to be even less exposed. The table below however illustrates that there are likely to be longer term results of a divestment campaign including the lowering of the intrinsic values of stocks due to a greater uncertainty about future cash flows due to the following:

1. Multiples compression – share price to earnings (P/E)
2. Legislative uncertainty – further restrictive legislation
3. Divergence of valuations

A recent signal of success for the Fossil Fuel campaigns has been Glencore's statement on limiting its coal production capacity broadly to current levels. This is being attributed to the significant engagement of the Climate Action 110+, which represents 300 investors who have US$37 trillion of assets under management.

Potential direct and indirect impacts of a fossil fuel divestment campaign



Source: Stranded assets and the fossil fuel divestment campaign: what does divestment mean for the valuation of fossil fuel assets? Atif Ansar, Ben Caldecott, James Tilbury, Smith School of Enterprise and the Environment

As stated within the Global Investor Statement on Climate *"As institutional investors and consistent with our fiduciary duty to our beneficiaries, we will: …work with the companies in which we invest to ensure that they are minimising and disclosing the risks and maximizing the opportunities."*[17] This approach differentiates engagement from divestment. However they are both a continuum of creating pressure.

"To deliver a strong investment case to our shareholders, we must invest in assets that will be resilient to regulatory, physical and operational risks related to climate change."
- **Glencore Climate Change Statement**[18]

Some investment commentators have labelled the Glencore move as opportunistic, trying to consolidate its market power and reduce supply within the Australian market.

Divestment Campaigns - Guns and Weapons

A galvanizing event in the US for many institutional investors, including the public retirement systems of teachers, was the mass shooting of children and teachers at the Sandy Hook Elementary School in 2012. The two largest public employee pension plans in the U.S., California State Teachers Retirement System (CalSTRS) and California State Public Employees Retirement System (CalPERS), both divested from firearms manufacturers in 2012.

Recent shooting incidents such as Las Vegas in 2017 and subsequent fears of restrictions on gun ownership had initially driven an increase in gun sales. However, more recently with the Marjory Stoneman Douglas High School shooting in Parkland, there have been drops and swings in revenue as gun manufacturers could be falling out with Institutional norms.

Interestingly the largest publicly traded U.S. firearms makers have a market value of less than a billion dollars and are classified as "small cap" companies on an index basis. Therefore these exclusions are not likely to introduce a great deal of tracking error to a portfolio.

Divestment campaigns have shown they often can create real societal change. From a financial perspective, divestment can contribute to uncertainty in capital markets through stigma, regulation and risk which may affect future cash flows and compress multiples. However in a global short term market place it is worth recognising that one person's ethics and stigma is another's investor's value investment.

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About the Author

After a successful career establishing the community program at ASIC and managing the MLC Community Foundation as part of the National Australia Bank Corporate Responsibility Leadership Team, Luke joined the JBWere Philanthropic Services team in March 2015. Beyond supporting our clients with tailored governance and strategy advice, Luke has been pivotal in the development and execution of JBWere's Socially Responsible Investment framework (ESG integration, ethical investing and impact investment).

Luke is a founding member of IMPACT100 Sydney funding network and serves as a non-executive board director of Batyr and the Balance Impact Investment Committee.

About JBWere Philanthropic Services

JBWere is the leading provider of Philanthropic and Investment Management advice to the sector, managing in excess of $7 billion across more than 600 client accounts across Australia and New Zealand.

The mission of the JBWere Philanthropic Services team is 'to inspire, educate and support of clients in delivering sustainable impact'.

We have the pleasure of working with a broad and diverse range of purpose-driven organisations, institutions, corporations, families and individuals. We partner with our clients to support them in delivering on their mission, and fulfil our own, through:

- Best Practice Governance;
- Research, Education and Insight; and
- Tailored Strategic Advice.

Please visit our website jbwere.com.au to download our Research and Insight papers.

To see how JBWere can help you or your organisation please contact us via phone (1300 263 166) or email (philanthropic.services@jbwere.com)

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