SOME TROUBLING QUESTIONS ABOUT ETHICAL INVESTING AND ON THE DANGERS OF EXCESSIVE STANDARDISATION

"…IN THE FINAL ANALYSIS, OUR MOST BASIC COMMON LINK IS THAT WE ALL INHABIT THIS SMALL PLANET. WE ALL BREATHE THE SAME AIR. WE ALL CHERISH OUR CHILDREN'S FUTURES. AND WE ARE ALL MORTAL."

JOHN F. KENNEDY - AMERICAN UNIVERSITY SPEECH, JUNE 1963.

We wholeheartedly welcome the trend toward ethical investing (I will use the term "ethical" as a catchall for ESG, SRI, Impact investing). While we have not yet integrated ethical investment considerations into our investment process, we have nevertheless steered our own business model in a way that makes it easier to assess how we invest our clients' money to achieve a degree of positive impact. Therefore, we have educated our clients on the benefits to society of micro credit finance for example, and when investing in a start-up within our venture capital activity one of the questions we ask ourselves is "how is this technology going to improve life?"

With the increasing demand for ethical investing, we are also witnessing the first important steps toward the formulation of guidelines that would make it easier for investors to assess companies' compliance to ethical principles (see the EU Directive 2014/95/EU). Concurrently, rating agencies have been established to "grade" individual companies. This will invariably bring about a degree of standardisation. However, there are dangers to standardisation, and the following personal experience is an illustration.

In 2015 I attended an event sponsored by a major European bank where they presented their new "ethical" fund. Since the mandate was to invest globally, the fund also had a list of investable and non-investable countries. At some point one of the attendees asked: "How do you determine which countries are investable and which are not?" The answer was that there are NGO's that classify countries based on a series of criteria which involve respect for human rights, democratic freedoms, etc, etc, etc. That's when I got curious and went through the appendix of the presentation which contained the list of countries that were deemed to be investable or non-investable. What I found was unsettling. When I managed to be alone with the portfolio manager during the stand-up lunch that followed the presentation, I respectfully asked: Why is it that I cannot invest in country X, but I can invest in any European automotive company – all of which are heavily invested in X? Why is "blank" investable when it won't even allow women to get a driver's permit, but I cannot invest in Y, where a woman is president of the country's central bank? ("blank" did eventually allow the issuance of driving permits to women in 2018, but not without strong resistance). What's democracy got to do with "blank", Z, W…? Why is this country investable when it discriminates openly against a religious minority that happens to be also indigenous to this country?

The Portfolio Manager simply smiled and said that they were merely following the generally recognised NGO classifications. Since she did not run away from me, I thought that I would ask the key question: What kind of due diligence was performed on this NGO? And who finances it? I did not get a particularly reassuring answer, but I did notice that the list of investable and non-investable countries coincided with the geo-political alignment of each of the countries assessed. This raises the issue which relates to the danger posed by standardisation: The potential for manipulating the ethical investing community.

There is also the question of banks being caught evading sanctions and ending up in the crosshairs of the US Department of Justice. The question here is: Is it right not to invest in a bank that evades unilateral sanctions when the sanctions themselves may be illegal? [1] Not to mention the fact that according to the UN, sanctions have caused hundreds of thousands of deaths because they make it difficult to buy vital medicines and medical equipment.

The dangers posed by standardisation are also illustrated in a very peculiar business practice universally applied by the US defence industry. The US is full of so-called think-tanks whose only mission appears to be that of providing the veneer of academic respectability for the identification of threats (real or imagined) which invariably require military intervention. This, of course, is good business for defence companies. If we go under the assumption that defence is necessary, there should be no reason to exclude a-priori weapons manufacturers from the investable universe because it simply won't make wars any less likely. But, when an industry actively finances warmongering think-tanks, then it is quite a different story. For this reason, we have never and will not invest in US (and UK) defence companies. And it does not matter that the company has a woman CEO (which scores a cheap point for inclusion) or has a very low carbon footprint. Wars have a terrible carbon footprint and are also inclusionary to the extent that they are equal opportunity killers.

By now you have understood that I have a problem with standardisation because it implies that someone else – perhaps even in bad faith – will be telling me what is ethical and what is not. The issues I raised above are examples of the debate the ethical investing community should at some point start to engage in.

Finance, in its most pristine manifestation, is the conduit by which the savings of the community are invested. If you are good at your job, you will identify healthy and growing companies that will make your investments yield a good return for your clients and in the process you will have facilitated the growth of wealth-creating companies. This, of course, is a strictly economic calculus and we, in the financial community, should not abandon this core task. But with the world becoming increasingly complicated and, in some ways, facing existential threats, it is only natural and desirable that non-economic considerations should become a permanent part of the investing process. By doing so we, in the financial community, will also become a conduit by which the savings of the community are channelled toward entities that take their social responsibility seriously, thereby contributing to a better world.

While ethical considerations have been a part of our informal investment process, we are working to design a formal process that is consistent with the core values that we apply in our daily work without falling into the trap of standardisation. Ultimately, the important thing is that we are all committed in good faith to do our best to perform a socially useful function without becoming victims of manipulative forces which, through the definition of standardised "criteria", may cause us to do the exact opposite of what we intended. This, in our way of thinking, is the most difficult challenge that ethical investors face.

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[1] "Unilateral" is the key legal term here because it implies "extra-territoriality", which is illegal according to international law.