INSIGHTS

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FINANCIAL ISSUES AFFECTING YOUR LIFESTYLE

ETHICAL INVESTING: A PASSING FAD, OR HERE TO STAY?

It's an investment approach that's growing in popularity, but can ethical investing deliver the financial returns you need?

Every day, serious issues like climate change, oceanic plastic pollution and threats of species extinction appear on our news feeds. These global challenges are set to impact every area of our lives for years to come – including our financial security.

Overseas, heads of central banks have acknowledged the far-reaching impacts of climate-related financial risks. This year, England's Mark Carney and France's François Villeroy de Galhau both warned of the need to transition to a greener economy to avoid financial risks like infrastructure damage, reduced productivity and huge losses for insurers.[1]

Back at home, the Reserve Bank of Australia and financial regulators have recognised the economic implications of climate change, along with the need for financial institutions to make environmentally conscious investment decisions.[2] Companies are also under increasing pressure from activists to take action on climate change and to tackle social issues like gender inequality.

As the challenges facing our world become more complex, many investors are demanding investment options that will make a positive global impact in line with their personal values. In fact, a recent study by the Responsible Investment Association Australasia (RIAA) found that 92% of Australians 'expect their super and other investments to be invested responsibly and ethically'.[3] But what does that mean exactly?

What is ethical investing?

Put simply, ethical or responsible investing is about avoiding investments in harmful practices or products. It can also mean choosing to invest in companies that actively make a positive social or environmental contribution.

As well as considering an investor's financial goals, ethical investing takes into account the investor's beliefs and values. Of course, everyone's values are unique, so an investment strategy that's right for one investor might not be suited to another.

RIAA describes a range of ethical investment strategies, which can be broadly divided into two categories.[4] The first category includes strategies that aim to prevent or minimise harm, such as:

- **Environmental, Social and Governance (ESG) integration:** ESG is a framework for evaluating a company's environmental, social and governance practices before making an investment decision. This approach may include assessing how the company uses energy and deals with waste and pollution, how it treats its workforce and supply chain, and its track record with consumer protection.
- **Negative screening:** The most popular ethical investment strategy worldwide, negative screening means avoiding or divesting from harmful products and activities like tobacco, armaments, fossil fuels or gambling.

1 M Carney, V de Galhau & F Elderson, *Open letter on climate-related financial risks*, 2019.

2 RIAA, *Responsible investment benchmark report Australia*, 2019.

3 RIAA, *From values to riches: Charting consumer attitudes and demand for responsible investing in Australia,* 2017.

4 RIAA, *Responsible investment benchmark report Australia*, 2019.

- **Corporate engagement and shareholder action:** This strategy aims to influence corporate behaviour. Shareholders might choose to attend board meetings, file proposals or engage in proxy voting to have a say in changing the company's activities or operations.

The second category includes strategies that contribute to social or environmental benefits, such as:

- **Positive screening:** This approach involves selecting companies, sectors or products that have a positive impact on the world. This could mean investing in recycling or waste management companies, or businesses that produce plant-based proteins to avoid the cruelty of meat production.
- **Sustainability-themed investing:** With this strategy, investors choose companies whose activities focus on specific environmental issues. These might include organisations that generate renewable power, green technology or sustainable forestry.
- **Impact or community investing:** The aim of this strategy is to choose investments that benefit society while generating financial returns. Examples of impact investments could be community health, education or housing initiatives, or companies that help find employment for disadvantaged groups.

How do ethical funds perform?

Around the world, socially responsible investments rose by a staggering 34% between 2016 and 2018 to US $30.7 trillion. In Australia alone, responsible investments were worth $980 billion as at 31 December 2018 – an increase of 13% on the previous year.[5]

There's no doubt that ethical investments are popular. But how do they stack up?

According to recent data, they do well. As at 31 December 2018, responsible investment funds outperformed 'mainstream'[6] funds over one, five and 10-year periods across a range of asset classes (Australian share funds, international share funds and multi-sector growth funds).[7]

Ethical investing has the potential to deliver returns, and sustainable investment markets are continuing to grow across the globe.[8] And as more of the environmentally and socially conscious millennial generation enter the investment landscape, ethical investing could continue rising in popularity over the long term.

The choice is yours

So how can you make sure your investments are aligned with your personal values? Your financial adviser can help you find the right strategy so you can invest in the things that matter most to you, without sacrificing your financial goals.

But first of all, it's worth spending some time thinking about the issues you care about and the types of industries you don't feel comfortable investing in.

Next, you can see which companies you're currently invested in through your super, along with any managed fund investments and direct shares you may have. You can ask your fund directly for a list of your investments.

If you'd like to change any of your investments, you could also research some companies or industries that you'd rather put your money into.

Finally, get in touch with your financial adviser to review your investment plan together and discuss your decisions. Your financial adviser will be able to talk through your options and the potential pros and cons of any changes you'd like to make. By working together, you'll be able to find the right investment strategy to match your needs, goals and values.

5 Global Sustainable Investment Alliance, Global Sustainable Investment Review 2018, 2018, as quoted in RIAA, *Responsible investment benchmark report Australia*, 2019.

6 The term "mainstream" has been used to describe funds that don't specifically apply a responsible investment strategy when selecting and managing their investments.

7 RIAA, *Responsible investment benchmark report Australia*, 2019.

8 RIAA, *Global sustainable investment review,* 2018.

HOW YOUR BEHAVIOUR AFFECTS YOUR FINANCIAL WELLBEING

When you're working towards your financial goals, you might be faced with all sorts of hurdles along the way. But could your own behaviour be the biggest stumbling block of them all?

Becoming financially secure doesn't just happen overnight. First you need a plan, and then you need to put in the hard yards to see it through.

But even with a watertight financial plan, life has a habit of throwing unexpected challenges our way which steer us off course. In many cases, these challenges may be beyond our control, like being retrenched or losing a loved one. But what about the factors you can control, like your own financial behaviour?

For most people, our financial behaviour is governed by our attitude to money. This affects the ways we spend, save and invest. For instance, do you always stay within your budget or do you have the occasional blowout? Have you put money aside for a rainy day? Or are you like one in six Australians who are struggling with credit card debt?[9]

Being aware of your financial behaviour can be an important step in your financial journey. By ditching your bad financial habits, you can instead focus on doing the things that will get you where you need to be.

Here are some red flags to look out for.

Clever marketing techniques

Think you're too smart to be swayed by flashy advertising? Salespeople and marketers use behavioural economics to manipulate our purchasing decisions, so you might be less immune to their methods than you think. Maybe you can see past 'free' offers, buy-one-get-one-free discounts and 'gift with purchase' rewards, but there's a good chance you've spent money during a sale or a limited-time offer on something you could do without.

Thinking expensive is best

Research has shown that people inherently expect cheaper items to be inferior. In one study, participants tasted a variety of wines labelled with randomly selected prices. In each case, they stated that the higher priced wines tasted better than the seemingly cheaper ones.[10] This kind of irrational value assessment can lead you to spend more than you need to.

Analysis paralysis

When you're faced with a variety of purchasing options, it's hard to know which one is right for you. And if the choices seem too overwhelming, sometimes it feels easier to not make a decision at all. This is one of the reasons why many people don't take up financial products and services that could genuinely improve their financial wellbeing, like a high-interest savings account or an investment portfolio to build wealth for the future.

Copycat spending

Ever bought something because your best friend or a family member did? While there's nothing wrong with basing your spending decisions on personal recommendations, it can sometimes make you blind to the options best suited to you. This is especially important when you're choosing financial products: everyone's situation and needs are different, and so your financial plan should be tailored just for you.

Excessive optimism

If you're in good health, with a stable job and a happy home life, you may think things will never change. But in a recent study, unexpected life events were found to be the single biggest factor preventing people from reaching their financial goals.[11] These life events may include health problems, accidents and injuries, relationship breakdowns, business failure or job loss, or taking on a care role for an elderly family member. Sometimes the financial fallout of these events can be catastrophic, but we'd still prefer to think the worst will never happen to us. As a result, many people don't plan for the unexpected – for instance, by getting the right insurance to protect them against financial loss.

Going it alone

You're in control of the decisions you make, but nobody's perfect and we could all use some support. That's why it helps to get guidance from your financial adviser whenever you're facing a major financial decision. They can also help you along the way by clarifying your long-term goals and teaching you day-to-day strategies to improve your financial behaviour.

Get the right advice

When it comes to making better financial decisions, your financial adviser can lend a helping hand. They can show you how to create a personal budget and grow your savings for the future – without missing out on the things you want now.

9 Australian Securities ASIC, *Credit card lending in Australia*, 2018.
10 L Schmidt, University of Bonn, *How context alters value*, 2017.
11 UNSW & Financial Literacy Australia, *Exploring financial wellbeing in the Australian context*, 2017.

Q&AS

Q: I'm 52 years old and my annual income is $90,000. Each year I salary sacrifice into super so that my concessional contributions reach the $25,000 cap. Will the recent tax changes affect how much I can salary sacrifice?

A: By salary sacrificing to super, you are swapping some salary (which would otherwise be taxed at your marginal income tax rate), for 'concessional' super contributions (which are taxed at 15%).

The government's recent tax changes occur in three phases: 1 July 2018, 1 July 2022 and 1 July 2024, and for you will broadly reduce the marginal tax rate that applies to some of your income. In particular, from 1 July 2024, you will pay only 30% tax plus Medicare levy on any income you earn over $45,000 pa but less than $200,000, which is less than the current tax rates that apply (which range from 32.5% plus Medicare levy to 45% plus Medicare levy).

However, while marginal tax rates are reducing, there can still be a substantial benefit in salary sacrificing to super. For example, from 1 July 2024, if you're still earning $90,000, for every dollar that you salary sacrifice within your concessional cap, you're saving 30 cents individual income tax, while paying 15% contributions tax – a benefit of 15 cents for each dollar.

It's important to ensure that any salary sacrifice contributions don't exceed your concessional cap, taking into account other concessional contributions such as your employer's compulsory Super Guarantee, which are set to rise gradually from 9.5% of your salary to 12% between 1 July 2021 and 1 July 2025, so you may have to adjust your salary sacrifice amounts from year to year to ensure you stay within your cap.

Q: My super is in two accounts, and one account only has a balance of $5,000. I don't contribute super to this account, but I keep it open for the insurance cover it provides. Will my fund close this account because it's considered to be 'inactive'?

A: From 1 July 2019, superannuation funds are required to close and transfer certain account balances below $6,000 to the ATO where they have been inactive (i.e. you haven't made any contributions or rollovers into the account) for at least 16 months. This won't apply where, during the 16 month period, you make changes to your investment options, insurance or certain death benefit nominations, or make a declaration that you don't want your account to be considered inactive.

Importantly, an account will also not be considered inactive and won't be transferred to the ATO where you have insurance cover in the account. So, as long as your cover continues, your account won't be transferred to the ATO.

Another important thing to be aware of from 1 July 2019 is that superannuation funds are required to cancel any insurance cover held in your account where it has been inactive (i.e. no contributions or rollovers have been received by the fund) for 16 months or more, unless you have specifically elected to maintain this cover.

If you wish to maintain your insurance cover, it is therefore important to ensure that you make this election to your fund to ensure that your cover will continue, even if your account is inactive for 16 months or more. This effectively ensures that your account will not be closed and transferred to the ATO.

Q: I'm 70 years old and still working part-time. I heard that the government will match any extra contributions I put into my super. Is this true?

A: The government co-contribution is a scheme where the Government will match 50% of any after tax contributions you make to super within certain limits.

The maximum government co-contribution is $500 if you earn $38,564 or less and contribute $1,000 or more. The maximum government co-contribution reduces as your income exceeds $38,564 and ceases if your income is $53,564 or more.

One of the important requirements to qualify for the government co-contribution is that you need to be less than 71 years old at the end of the financial year in which you're contributing – so you may be able to take advantage of this initiative in this financial year if you're still age 70 on 30 June 2020, but unfortunately you won't qualify next financial year or in future years.

If you're earning $37,000 or less and are making pre-tax (concessional) contributions to super, such as super guarantee or salary sacrifice from your employer or personal tax-deductible contributions, you could also qualify for a different type of Government contribution known as the low income super tax offset. Under this incentive, the government will match 15% of your pre-tax contributions, up to a maximum government contribution of $500. No upper age limit applies, however it is important to note that you can generally no longer make voluntary contributions to super from age 75.

There are a range of other eligibility requirements that also apply to be eligible for the co-contribution or low income super tax offset, including that at least 10% of your income comes from employment or running a business, speak with your financial adviser to make sure that you will qualify.

To make most voluntary contributions to super while aged 65 to 74, you must have also satisfied a work test (working for 40 hours in a 30 consecutive day period) during the financial year, or qualify for a work test exemption. Voluntary contributions generally can't be made from age 75.

SPEAK TO US FOR MORE INFORMATION

We're here to discuss any questions or concerns you may have.

IMPORTANT INFORMATION

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