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ESG & Sustainability

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Module 1

ESG & Impact: an introduction

ESG & Impact: an introduction

Today's global challenges present unprecedented risk to economic development, human well-being, and natural ecosystems. For asset owners with a long-term investment horizon, these environmental, social, and governance (ESG) risks are coming into increasing focus and changing the context for investing. Many are starting to incorporate these factors into portfolio construction through sustainable investment practices—simply defined as investment strategies that take into account material ESG factors. When done right, sustainable investing can give investors an edge to mitigate risks and, in some cases, drive outstanding long-term returns.[1]

Sustainable investing is an investment approach characterized by the explicit incorporation of ESG factors in the investment process. The inclusion of non-financial performance data in the analysis of constituent companies or managers gives this approach a broader lens than traditional investing. There are myriad strategies for implementing sustainable investing in portfolio construction and management. These can include negative screening, positive screening, ESG integration, impact investing, and shareholder engagement. These strategies lead to varying outcomes on ESG issues, but fall under the heading of sustainable investing so long as they incorporate ESG factors. To wit, sustainable investing is defined by process rather than by achievement of specified outcomes. As discussed in this section, a strict definition of the term has yet to solidify, and terms continue to be used inconsistently throughout the market.[2]

[1] Friede et al. 2015; Morgan Stanley 2015a; Trunow and Linder
[2] World Resources Institute's Working Paper, Navigating the Sustainable Investment Landscape

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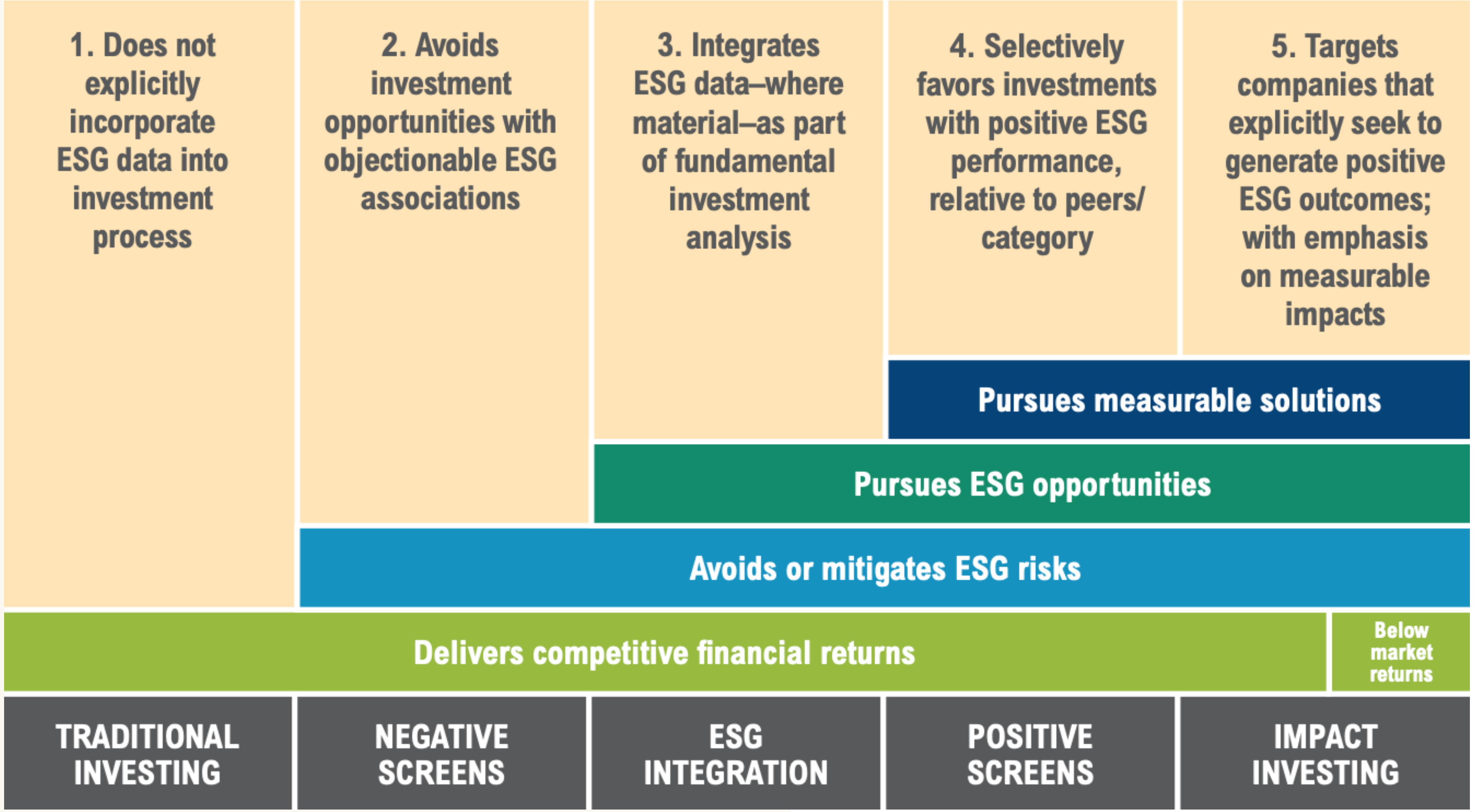

World Resources Institute, adapted from Bridges Ventures

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APPROACH	DEFINITION	IMPLEMENTATION	ASSET CLASSES
Sustainable investment	**An umbrella term for all strategies that incorporate ESG factors into investment decisions alongside financial analysis. Other catch-all terms that are used in similar ways but are distinct in meaning include responsible investing, values-based investing, mission-aligned investing.**	**Introducing ESG data and analysis into existing investment approaches. This category is inclusive of all other strategies and examples outlined in this table.**	**All, depends on the specific investment strategy.**
Negative screens (exclusions)	The explicit exclusion of certain investment opportunities deemed unethical or controversial. This is often referred to as socially responsible investing. While historically pursued for ethical reasons, negative screens can also be applied for material concerns; for example, to avoid the potential risks of stranded fossil fuel assets.	Excluding holdings in fossil fuel reserves—or avoiding companies that generate revenue from alcohol, tobacco, gambling, weapons or other sectors—that are inconsistent with investment beliefs.	Public equities, private equities, real assets, fixed income.
Positive screens	The strategic inclusion of companies, managers, or sectors with a record of positive ESG performance relative to industry peers. In some cases, positive screens are referred to as solutions-oriented investments.	Overweighting industry leaders across multiple sectors in a portfolio or pursuing thematic investments that focus on specific ESG factors or industries. This includes solutions-oriented investments like low-carbon or healthcare funds.	Public equities, private equities, real assets, fixed income.

World Resources Institute, based on information from US SIF, PRI, GIIN and Ceres.

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APPROACH	DEFINITION	IMPLEMENTATION	ASSET CLASSES
ESG integration	The systematic incorporation of ESG factors where material to performance, as complementary to fundamental analysis. As a more holistic analysis than traditional investing, ESG integration is often pursued as a means of improving investment performance. The specific ESG factors included may be selected according to materiality to the portfolio and/or relevance to the asset owners.	*Best-in-class:* selecting companies/managers with highest ESG performance. *ESG tilt:* overweighting holdings with higher ESG performance. *ESG momentum:* overweighting holdings with improving ESG performance. *ESG-specific criteria:* using any ESG criteria, including targets or thresholds.	Public equities, private equities, real assets, fixed income.
Impact investing	Investments in companies or funds with the primary intention of generating positive social and/or environmental impact alongside financial returns. These investments are typically made in private markets, and can span a wide range of financial return expectations, from concessionary to market-rate. Foundations pursue these investments both as program-related investments and mission-related investments, as defined by the IRS. Reflecting an evolution of the term, "impact investing" is sometimes used as an umbrella term synonymous with sustainable investing. In that use, the idea becomes a more scalable approach with broader appeal to mainstream investors, rather than a "pure impact" strategy.	Purchasing of community investing notes, investments in a private equity fund, direct investments in social enterprises.	Private equities, debt, and venture capital. Also includes guarantees, fixed income, and public equities.
Shareholder engagement	Pressuring for ESG change within publicly traded companies through proxy voting, filing shareholder resolutions, or engaging in other formal advocacy. This approach offers a sharp contrast to negative screens, as investors maintain company shares in order to keep their seat at the table for engagement.	Proxy voting, filing shareholder resolutions, investor coalitions.	Public equities

World Resources Institute, based on information from US SIF, PRI, GIIN and Ceres.

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At State Street Global Advisors, Chris McKnett analyzed how large investors, like banks, pension funds and endowments, can put their money in the right places -- not just for better business, but for a better world. McKnett developed sustainable-strategic products and integrated sustainability thinking directly into the investment process.

Video Embed to play in browser:
https://www.ted.com/talks/chris_mcknett_the_investment_logic_for_sustainability/discussion

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As an entrepreneur, Six Sigma blackbelt, and technologist, Tynesia is uniquely positioned to catalyze a results-driven era of social change. As President and CEO of CapEQ™, which she founded in 2011, she demonstrated how business and community goals can align towards mutual outcomes, helping Fortune 500 clients like the Carlyle Group, Marriott, and others change the way the world does business.

Video Embed to play in browser:
https://www.ted.com/talks/tynesia_boyea_robinson_understanding_the_social_impact_of_investing

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Jason Clay leads the work of WWF-US on agriculture, aquaculture, business and industry, finance, fisheries, and forests. He explains how corporations, non-profits and educators can work together to save our planet's natural resources using real world examples.

Video Embed to play in browser:
https://www.ted.com/talks/jason_clay_how_big_brands_can_help_save_biodiversity?language=en

Module 1: Assignment

Read the following:

1. The Promise of Impact Investing, International Financial Corporation
2. Navigating the Sustainable Investing Landscape, World Resources Institute
3. Introduction to Investing for Impact, Harvard Business School

Watch the following:

1. https://www.ourplanet.com/en/explore/one-planet