



# Navigating the Alphabet Soup



A GUIDE TO SUSTAINABLE INVESTING



INVESTMENTS

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# Focusing on sustainable investing—without the confusing terminology

*If you're overwhelmed by the number of acronyms associated with sustainable investing, you're not alone.*

In recent years, investors have become increasingly interested in strategies that incorporate non-financial factors in the investing process. A 2018 report from the Forum for Sustainable and Responsible Investment (US SIF) stated that U.S. assets linked to sustainable strategies have reached \$12.0 trillion, up 38% from \$8.7 trillion in 2016.<sup>1</sup> Many of these strategies fall under the term “sustainable investing,” though there’s an almost dizzying number of other names, including “responsible investing,” “impact investing,” “ethical investing,” “green investing,” “mission-related investing,” and “values-based investing,” among many others. While each approach has a nuanced difference, for our purposes, we’ll use the umbrella term “sustainable investing” to refer to these strategies, as that appears to be the broadest and most accepted name for this category in the industry.

Along with the range of names for sustainable investing, several acronyms—such as “ESG,” “SRI,” “SDG,” and “PRI”—have also emerged in this space. For an already acronym-loving industry, the result has been an almost head-spinning number of acronyms and terms within the sustainable investing universe. The result is a wake of confusion—even among proponents of sustainable investing. A 2017 study found that even among investment firms that actively practice sustainable investing, **more than half (56%) said that there was internal confusion about ESG terminology within their organizations.**<sup>2</sup>

We’re hoping to clear up the confusion for you by defining some of the key terms and acronyms of sustainable investing. We’ll broadly explain the differences between the major investment approaches and discuss how the United Nations sponsored Principles for Responsible Investing (“PRI”) is transforming the landscape of sustainable investing. We want to demystify the terminology and abbreviations so that you can understand the benefits of sustainable investing without being overwhelmed by jargon and acronyms.

1. Source: The Forum for Sustainable and Responsible Investment (US SIF), “Trends Report 2018.”

2. Source: State Street Global Advisors, “ESG Institutional Investor Survey: Performing for the Future,” 2017.

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*SRI generally entails avoiding sectors or countries that do not align with an investor's worldview.*

## The original approach: Socially Responsible Investing (SRI)

The first major acronym of sustainable investing is “SRI”—which refers to “socially responsible investing.” SRI strategies generally follow an exclusionary approach—eliminating exposure to certain sectors such as tobacco, alcohol, gaming, and weapons, or avoiding all exposure to companies in specific countries. This approach has a long history that extends back to at least the 18th century, as religious groups sought to align their investments with their worldview. For instance, the Methodists and Quakers refused to invest in entities affiliated with the slave trade. In more recent times, it’s generally acknowledged that the widespread boycotts of South African companies during the 1970s and 1980s helped end Apartheid.

Broadly speaking, modern SRI approaches rely on screens to filter out categories of investments that an investor wishes to avoid in their portfolio. Institutional investors have blazed the trail in SRI investing over the years. For instance, in 2001 the California Public Employees’ Retirement System (CalPERS) voted to divest from tobacco company stocks in its portfolio.<sup>3</sup> Public pension plans in states ranging from California to New Jersey have considered excluding companies in entire countries—such as Brunei, Cuba, Iran, Saudi Arabia, Sudan, and Turkey—from their portfolios due to poor human rights records and potential ties to terrorism.<sup>4</sup> Overall, the decision to avoid specific sectors and countries aims both to do good in terms of social impact, as well as to serve as a prudent investment decision.

3. Source: Randy Diamond, “CalPERS Decision to Divest from Tobacco Is Costly,” Chief Investment Officer, 12/12/18.

4. Source: Anna Petri, “Policies Drive Public Pension Divestments,” National Conference of State Legislatures, Vol. 27, July 2019.



## The next evolution: ESG integration

The second major acronym is “ESG,” which stands for “environmental, social, and governance.” The term “ESG” entered the mainstream in 2005 as part of a United Nation-sponsored initiative, which served as the first step in establishing environmental, social, and governance as key components of analysis, processes, and decision-making in investment management.<sup>5</sup> While SRI investing takes a primarily exclusionary approach—seeking to avoid sectors or countries—ESG investing is an inclusionary approach based on the idea that companies with strong environmental, social, and governance practices may provide a source of long-term value that cannot be captured by traditional financial analysis. To oversimplify, SRI generally represents the past of sustainable investing, while ESG integration represents the present.

### What does ESG stand for?<sup>6</sup>

Since ESG investing is comprised of a range of issues, below is a general summary of what each term entails:



**Environmental**—Issues relating to the quality and functioning of the natural environment, including areas such as: greenhouse gas (GHG) emissions, climate change, renewable energy, energy efficiency (i.e. air, water or resource depletion, or pollution), and waste management.



**Social**—Issues relating to the rights, well-being and interests of people and communities, including areas such as: human rights, labor standards, workplace health and safety, employee relations, diversity, consumer protection, and controversial weapons.



**Governance**—Issues relating to the governance of companies and their stakeholders, including topics such as: board structure, size, diversity, skills, and independence (i.e. executive pay; shareholder rights; stakeholder interaction; disclosure of information; business ethics; bribery and corruption; internal controls and risk management).

Like SRI approaches, ESG investing often includes using screens. However, instead of screening out “bad” investments, ESG approaches use screens to identify “good” companies that could outperform. While SRI strategies may give up returns if their excluded “bad” sectors or countries performs strongly, ESG strategies tend to seek out “good” companies that view positive environmental, social, and governance factors as another alpha source. A broad academic report analyzing more than 2,000 studies supports the contention that companies with good ESG profiles have outperformed their traditional counterparts over time.<sup>7</sup> Investment managers following an inclusive ESG approach aim to capitalize on the idea that “good” companies can help their clients do well.

*ESG investing believes that companies with strong environmental, social, and governance practices may provide a source of long-term value that cannot be captured by traditional financial analysis.*

5. Source: World Bank Group, “Investing for Long-Term Value,” October 2005.

6. Source: Adapted from the United Nations Principles for Responsible Investing (UNPRI).

7. Source: Gunnar Friede, Timo Busch & Alexander Bassen, “ESG and financial performance: aggregated evidence from more than 2000 empirical studies,” *Journal of Sustainable Finance & Investment*, 5:4, 210-233, 2015.



## The road ahead: Impact Investing (II)

Impact investing (sometimes referred to as “II”) is an extension of ESG investing and a growing area of interest for investors. Impact investing goes a step further than ESG in that impact investments are made with the explicit intent to generate positive, measurable social and environmental effects in addition to a financial return. According to the Global Impact Investing Network, the impact investing universe represented more than \$500 billion of assets globally at the end of 2018.<sup>8</sup>

Examples of impact investing include “green bonds,” which fund projects that aim to combat global warming and “social bonds,” whose proceeds are dedicated to projects aimed at improving social welfare or helping disadvantaged populations, among other initiatives.<sup>9</sup> While impact investing represents a relatively small portion of the global investment universe, there’s a lot of room for these assets to grow.

**Table 1:** Key Investment Terms<sup>10</sup>

Acronym	Full Term	Definition
ESG	Environmental, Social, and Governance	An investment approach that considers the environmental and social impact of a company’s actions, along with the company’s corporate governance structure and activities. Often features an <i>inclusionary</i> approach that aims to invest in companies with positive factors.
SRI	Socially Responsible Investing	An investment approach that aligns an investor’s goals and values within a portfolio or strategy. Often features an <i>exclusionary</i> approach to restrict companies, sectors, or investments that do not align with an investor’s worldview or tenets.
II	Impact Investing	Investments made with the explicit intent to generate positive, measurable social and environmental impact alongside a financial return.

**Table 2:** Regulatory Bodies and Frameworks<sup>10</sup>

Acronym	Full Term	Definition
SASB	Sustainability Accounting Standards Board	A framework that aims to help businesses around the world identify, manage, and report on the sustainability topics that matter most to their investors.
SDG	Sustainable Development Goals	A collection of 17 global goals set by the United Nations General Assembly that aim to end poverty, protect the planet, and ensure all people enjoy peace and prosperity.
TCFD	Task Force on Climate-Related Financial Disclosures	An organization that has developed voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers, and other stakeholders.
UNGC	United Nations Global Compact	A voluntary initiative based on CEO commitments to implement universal sustainability principles and to take steps to support UN goals.
PRI	United Nations Sponsored Principles of Responsible Investing	A UN initiative that works to understand the investment implications of ESG factors and to support its international network of investor signatories in incorporating these factors into their investment and ownership decisions.

8. Source: Global Impact Investing Network, “Sizing the Impact Investing Market,” 4/1/19.

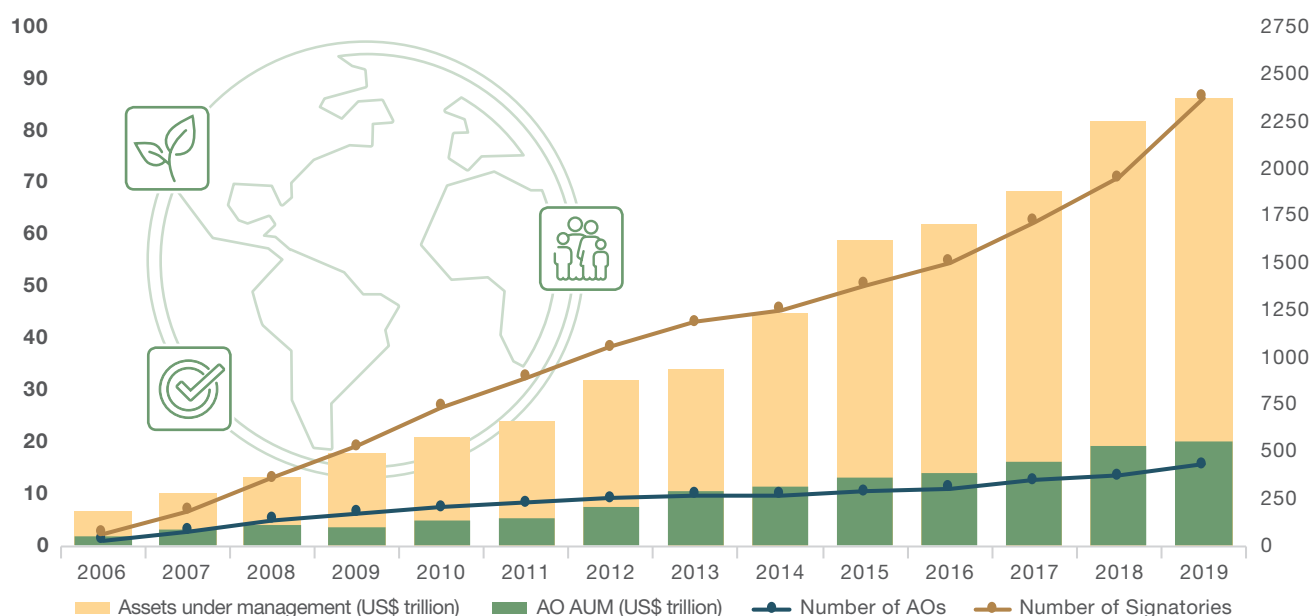
9. Source: Lyubov Pronina, “What Are Green Bonds and How ‘Green’ Is Green?” Bloomberg, 3/24/19.

10. Sources: Global Impact Investing Network (GIIN), United Nations Development Program, Sustainability Accounting Standards Board, United Nations Global Compact, United Nations Principles of Responsible Investing, Task Force on Climate-related Financial Disclosures, 2018.

## PRI: A new paradigm for sustainable investing

The last major acronym is “PRI,” which stands for the United Nations sponsored Principles for Responsible Investment. The PRI comprises six principles governing how signatories—both asset owners and investment managers—must address ESG factors in their investment processes, as well as measure and report on their methods. Since its launch in 2006, the number of PRI signatories and assets managed by those signatories has grown exponentially, as shown in Figure 1.<sup>11</sup> As of 2018, more than 2,000 asset managers and close to 500 asset owners had become signatories, covering an estimated \$90 trillion in assets globally.

**Figure 1: The Growth of PRI Signatories and Assets<sup>12</sup>**  
**Assets under management (US\$ trillion)**



What does this mean? The growth of PRI signatories has formally entrenched ESG analysis into the investment process for many asset managers and asset owners. Along with other global initiatives (see Table 2 for more examples), the PRI has clearly focused attention on sustainability as a key component of investing.

### What's next?

*Sustainable investing—no matter the names or acronyms to describe it—is here to stay. We hope that deciphering some of the potentially confusing terminology will help you jumpstart your next investment conversation in this growing area.*

11. Source: The Forum for Sustainable and Responsible Investment (US SIF), “Trends Report 2018.”

12. Source: PRI, 3/31/19

## **ABOUT RISK**

All investments are subject to market risk, including possible loss of principal.  
Diversification cannot assure a profit or protect against a loss in a declining market.

## **DEFINITIONS**

**Alpha** is a term used in investing to describe a strategy's ability to beat the market or provide excess return.



## INVESTMENTS

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