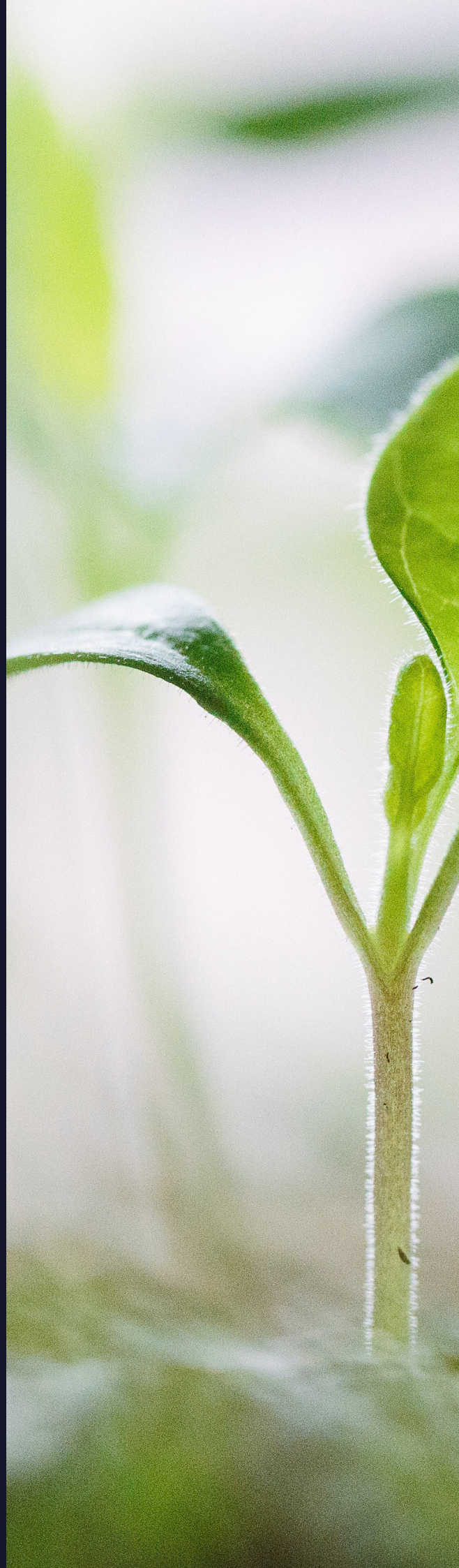


Blackfinch Group

Defining ESG Investing for Your Business and Clients

May 2021



Gaining Clarity on ESG

With a groundswell of interest in environmental, social and governance (ESG) investing, clients are focused on ESG solutions and advisers are working to meet demand. But as interest in ESG has grown, so has confusion. Common questions are: What is the definition of ESG? How is ESG measured? How are ESG considerations applied during the investment process, and what does ESG mean for returns?

ESG is certainly complex. It is also an umbrella term, used broadly to describe many different investment approaches and strategies. Therefore, advisers who can gain clarity on ESG, talk through the options with clients, and explain how it can positively affect returns, will be best placed to offer meaningful assistance. For adviser firms, this understanding of ESG can go hand in hand with ensuring ESG readiness overall, particularly with new legislation on the horizon.

ESG and its Sub-Sets

There's no official definition for ESG. But fundamentally, it is about investing with consideration for the positive influence a firm has on the environment and society, and how it's managed. It is also a way for companies, their staff, shareholders and potential investors to gauge how they respond to climate change, treat their workforce, manage their own supply chains, and cultivate innovation and build trust in their brand.

Yet media discussion around ESG has increasingly focused on business governance rather than sustainable products. More recently, the mainstream press has used ESG as a catch-all term for investing with a 'responsible' or 'ethical' focus.

This terminology reflects several distinct approaches to ESG, as noted below. It is important to remember that ESG investing takes in all of these, and is far broader than any of them. Discussing these approaches with clients can be helpful in educating them and pin-pointing areas of particular interest. Similarly, advisers may wish to confirm each product provider's own approach.

- **Responsible investing:** Investing while incorporating ESG factors.
- **Ethical investing:** Selecting investments based on ethical or moral principles (i.e., sales of armaments or alcohol).
- **Green investing:** Focusing on environmentally-friendly businesses (e.g., renewable energy firms).
- **Social impact investing:** Working for a measurable positive outcome alongside a return.
- **Sustainable investing:** Meeting needs without damaging or compromising the ability of future generations to meet their own needs.

ESG Investment Processes

Although new legislation has not yet been confirmed, it is expected that advisers will need to conduct extensive due diligence on firms to arrive at a focused solution for clients. Investment companies will need to show a genuine commitment to ESG, with its principles embedded in their investment processes. This will also help weed out those that are ‘greenwashing’, with ESG being used as part of a marketing ploy to attract new customers or greater investment and nothing more.

Many firms are already producing clear ESG policies, setting out their strategies and how they score and can be held accountable on ESG. The screening process is central, where prospective investee companies are filtered in or out according to provider criteria. Investment managers may employ positive screening, looking at how well a firm is doing on ESG factors, and may also use negative screening, excluding those that don’t measure up in terms of activities or sector focus.

Positive screening can also allow for engagement, not only with leaders but improvers on ESG, with a focus on effecting positive long-term change. This also broadens investment scope. Most importantly, it means investment managers are working closely with firms as part of their ongoing process.

ESG & Return Potential

By actively engaging with firms on ESG, investment managers are helping to build value into businesses. Holding firms accountable to their ESG commitments can contribute to stronger, better-managed companies. In fact, there is a correlation between improved ESG factors and share price performance. This may come as a surprise to some clients.

Another misconception around ESG is that investors may have to sacrifice returns in exchange for upholding ESG values. But investing in firms strongly aligned with ESG factors can lead to higher returns. Such firms operate with greater transparency and carry less reputational risk, meaning they are better placed for success. While returns across products will differ, investments in ESG companies are increasingly being regarded as a true source of alpha, rather than just a framework to mitigate risk.



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If you are looking to find out more about ESG investing, or get support on how to integrate ESG into your advice process, please contact us.

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