Life \ Pensions \ **Investments**

Understanding sustainable investment and ESG terms

Jargon Buster

Sustainable or Responsible Investment is a significant theme in investment markets today; with increasing regulatory obligations coming onto advisers from August 2022, there will be a growing focus on this key topic. However, one of the main issues for customers and advisers alike is the breadth of acronyms and terms used to describe this investment approach.

In this section, we hope to help you navigate the most used terms. We hope this will support your own advisory recommendations and conversations with customers.

Types of Investment Strategies

ESG: ESG is an acronym which stands for Environmental, Social and Governance. ESG represents the additional lenses an investor may choose to evaluate an investment alongside purely financial factors. Examples of what ESG factors cover vary but they can include:

> **Environmental factors** include aspects such as the contribution a company makes to climate change through greenhouse gas emissions, along with waste management and energy efficiency.

> **Social factors** include aspects such as human rights, labour standards in the supply chain, any exposure to illegal child labour, and more routine issues such as adherence to workplace health and safety.

> **Governance factors** include aspects such as board structure, executive compensation and approach to shareholder rights.

Ethical: A type of investing where investments are chosen on ethical grounds. Typically, this involves avoiding investments which manufacture certain types of products or are involved in certain industries that may be considered harmful or misalign with personal values, such as tobacco, adult entertainment and gambling.

Screened: An investment approach that uses explicit filters to decide which securities are eligible or ineligible for investment, e.g., involvement in certain industries, or companies which breach specified international norms.

Sustainable: An investment approach that considers ESG factors in determining whether to invest or not and, if so, to what extent in any single investment.

Responsible: An investment approach that considers ESG factors in determining whether to invest or not and, if so, to what extent in any single investment.

Impact: An investment approach where investments are made with the intention to generate social and environmental impact, alongside a financial return. Impact investing can be associated with lower financial returns, though this is not always the case.

Thematic: An investment approach that aims to maximise or exploit opportunities from major long-term sustainability-related trends that will drive value across industries.

Investment Approaches

Negative Screening or Exclusions: A strategy designed to specifically exclude companies, sectors or countries based on their involvement in certain activities centered on specific criteria. Common criteria include weapons, pornography, tobacco, or fossil fuel manufacturers. Exclusions can be applied at the individual fund level but are increasingly being set at a firm-wide asset manager level, across the entire range of assets.

Positive Screening: A strategy designed to specifically identify and invest in companies based on their positive ESG practices. Some of these good practices may include the promotion of human rights and reduced carbon emissions.

Integration: A process that considers ESG factors together with the typical financial ones. The process allows investments in any business, sector, or region, provided that ESG risks are assessed. It should be noted that those following an ESG Integration strategy only require that ESG factors are considered alongside other factors, and this is not the sole consideration in the investment process.

Norms based approach: This is outlined as the screening of investments according to their compliance with international standards and norms based on ESG criteria, such as those developed by the Organisation for Economic Co-operation & Development (OECD), the United Nations (UN), and various UN agencies/programs, such as the UN Global Compact, the International Labour Organisation (ILO), and the UN International Children's Emergency Fund (UNICEF).

Best in Class: An investment approach which focuses on companies that are leaders in meeting sustainable standards. The approach can vary from selecting the best performing companies to excluding the worst.

Active Ownership: The process of using an investor's ownership rights, including both voting and direct engagement with companies, to influence their strategy, objectives, performance, risk, structure, and corporate governance. The goal is to enhance shareholder value, by helping companies to achieve their potential while also delivering benefits to society and the environment.

Engagement: Shareholders of a company actively start a dialogue with the companies in which they are a shareholder to improve ESG strategy and practices. Engagement on ESG can take the form of formal letters, calls, emails, meetings, etc.

Voting: A formal policy on voting at the Annual General Meeting (AGM) of companies to influence a company's ESG strategy and practices.

Responsible Investing Glossary

Article 6 Funds: A classification under the EU's Sustainable Finance Disclosure Regulation (SFDR) framework for funds that do not incorporate sustainability into their investment objective.

Article 8 Funds: A classification under the EU's SFDR framework for funds that may incorporate sustainability into their investment objective but where it sits alongside other factors (e.g., return or risk) and may be of equal or greater or lesser importance.

Article 9 Funds: A classification under the EU's SFDR framework for funds that have an explicit sustainability objective.

Best in class: The inclusion of investment opportunities demonstrating higher performance on ESG factors than their peers.

Carbon footprint: The measurement of an entity's total greenhouse gas emissions.

Carbon pricing: The assignment of a value to greenhouse gas emissions, particularly carbon dioxide emissions, as a mechanism to account for and quantify such emissions and the ultimate responsibility for the environmental cost.

Climate change: Significant long-term change in the climate of a given region. Global scientific consensus is that the planet is currently experiencing a change in climate with over 97% of actively publishing climate scientists agreeing that this is the case.

Divestment: The intentional removal of holdings from an investment strategy as a tool to both highlight an issue and to indicate the strategy's directionality on the issue. The term is most frequently associated with fossil fuels.

Echo voting: A system through which the proxies of a passive investment strategy are voted at the direction of an actively managed investment strategy.

Environmental factors: Factors related to environmental performance used in the investment evaluation process. These include data points encompassing areas such as emissions, water use, energy consumption, waste generation, etc.

Environmentally Sustainable Investment: An investment in one or several economic activities that qualify as environmentally sustainable under the Taxonomy Regulations.

ESG: An acronym standing for environmental, social, and governance.

ESG integration: The integration of material and relevant ESG factors into the investment analysis process to better evaluate investment risk and opportunity.

Exclusionary screening: The intentional exclusion of investment opportunities based on industry or geographic exposure, non-financial performance indicators, moral considerations, or other elements of concern to a defined set of investors.

Fossil fuel: An all-encompassing term used to describe coal, oil, petroleum, natural gas, and other hydrocarbons used to generate energy.

Fossil fuel free: An investment strategy that intentionally excludes investments with ties to the fossil fuel industry. This typically includes exploration, extraction, refining, transportation, and sale of fossil fuels as well as energy production based on such fuels. The strategy may also be extended to include more indirect or peripheral participants in the fossil fuel industry.

Governance factors: Factors related to the governance structure of an investment opportunity. These include data points such as executive compensation, board composition, shareholder access, etc.

Green bonds: Bonds issued in which the use of proceeds includes the funding of new or existing projects with environmental benefits such as renewable energy, energy efficiency projects, clean water, or mass transit. Green bonds can be self-labelled under the auspices of programs such as the Green Bond Principles or the Climate Bonds Initiative, or they may be unlabeled.

Green investing: An investment approach that emphasises criteria relating to the environmental impact of the underlying investment.

Greenwashing: Falsely communicating the environmental aspects of a company to make it seem more environmentally friendly than it is.

Impact investing: The allocation of capital to strategies seeking intentional and measurable positive ESG outcomes in addition to a market rate return.

Insurance Distribution Directive (IDD): Legislation which regulates how insurance products are designed and distributed in the EU.

Principal Adverse Impacts (PAIs): The negative, material, or likely to be material effects on sustainability factors that are caused, compounded by, or directly linked to investment decisions and advice performed by the legal entity.

Proxy voting: A process through which shareholders designate a representative to vote their shares in a listed company. Shareholders vote on issues such as electing directors to the board, mergers and acquisitions, board remuneration and capital measures.

Renewable energy: Energy derived from renewable sources such as wind, solar, hydro, and geothermal.

Responsible investing: A term used to describe an approach to ESG investing that focuses largely on ESG integrated criteria. The term is often used to describe any strategy encompassing ESG factors.

Shareholder engagement: The process of engaging with an entity as a shareholder to begin or continue a dialogue related to issues of concern to investors including ESG practices, disclosure, and other corporate behaviours.

Social factors: Factors related to social performance used in the investment evaluation process. These include data points encompassing areas such as diversity, human rights, labour relations, etc.

Socially responsible investing (SRI): A term used to describe an approach to ESG investing that focuses largely on exclusionary criteria. SRI has been used as a descriptive term for over three decades and is often used to describe any strategy encompassing ESG factors.

Stranded asset: An asset that loses value or turns into a liability before the end of its expected economic life. In the context of fossil fuels, stranded assets are those fuel reserves that will not be able to be extracted if action is taken to address climate change. As a result, investments with significant exposure to stranded assets may be negatively affected.

Sustainable investing: A term used to describe an approach to ESG investing that focuses largely on positive inclusionary criteria. The term is often used to describe any strategy encompassing ESG factors that has a strong emphasis on environmental factors.

Taxonomy: A single EU wide scheme of classification for economic activities that aims to enhance transparency concerning sustainable activities. The EU taxonomy provides companies, investors, and policymakers with appropriate definitions for which economic activities can be considered environmentally sustainable. The Taxonomy Regulation came into force on 12 July 2020. Sustainable Investment may or may not be aligned with the Taxonomy.

Thematic investing: A term used to describe an approach to investing that focuses on clearly defined themes. In the context of ESG, it is used to refer to strategies that are focused on discrete concepts such as clean tech, renewable energy, water, etc., or a strategy that is based on a set of faith-based guidelines.

United Nations Sustainable Development Goals: A set of 17 goals promulgated and supported by the UN that attempt to provide a path to address global challenges such as poverty, inequality, climate change and environmental degradation to achieve a more sustainable global future.