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ESG, SRI, Impact investing – what do they mean?

"What is your opinion about Socially Responsible Investing (SRI), Environmental, Social Governance (ESG) investing, Responsible Investing and Sustainable Investing—and how can I get more of it into my portfolio?"

According to recent State Street research, this sort of question from clients is likely to be on the rise: 43% of investors who do not currently use an ESG approach plan to discuss potential opportunities with their advisor in the next 12 months.

Are you prepared?

This crib sheet can help get you up to speed.

First things first

- When clients ask about responsible investing (or hint at it), it's typically a topic to which they have given thought—it's not usually a spontaneous question.
- Ask clarifying questions to understand your clients' motivation in this domain because the terms SRI, ESG, Responsible Investing, Sustainable Investing, etc. can mean different things to different people.
- Portfolio implementation is likely to vary depending on the client's underlying intention.

- Look out for clues: Your clients may not actually come out and use any of the more technical SRI, ESG etc. terms when they want to engage with you in a conversation about responsible investing. They may use more vague phrases like "wanting to do better" or "wanting to make a difference." They may mention they drive an electric car, conserve water or buy fair trade coffee.
- Don't underestimate the potential business benefits of engaging clients about responsible investing. This conversation can provide powerful insight into your client's values and priorities—which can form a sound basis for deeper relationships.

Five common portfolio implementation approaches for responsible investing

Exclusionary / negative screening

This is the oldest type of responsible investing; avoiding securities based on values. Commonly thought of as ‘socially responsible investing.' An example might be a religious organization screening out ‘sin' stocks from their investment portfolio.

Impact investing

Investing with the intent to generate and measure social or environmental benefits alongside a financial return. Examples might be community banking or microfinance investing.

Best-in-class selection

Preferring companies with better or improving ESG scores relative to peers. This might include investments in companies with a better environmental or human rights record than peers. Compared to exclusionary screening, the "best-in-class selection" approach takes a more positive view, choosing companies with more favorable environmental, social, or governance factors.

Thematic investments

Investments that are based on trends or structural shifts, like social, industrial and demographic trends. Examples might include investments related to clean energy, animal welfare or diversity on corporate boards.

Shareholder advocacy/engagement

Shareholder engagement gives investors a voice in the boardroom; it's a form of activism. Active ownership (exercising stock ownership rights) works to affect change with company management on ESG issues. This can take the form of actively voting shares in a targeted manner, direct engagement with management and/or board, or filing shareholder proposals.

The bottom line

The field of responsible investing has evolved significantly since its nascent days in the 1970s and 1980s—and interest among investors seeking to incorporate such an approach into their portfolios is on the rise. Be prepared for these conversations—they key is asking clarifying questions and listening carefully to unpack the best way to help clients achieve their responsible investing goals. The time will be well-spent: those conversations can help you further deepen client relationships and differentiate yourself from peers.

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