Standard Life
There's a lot to look forward to

Responsible investment: the basics

Incorporating environmental, social and governance (ESG) issues into investments

There's lots of choice for people who want to invest in ways that consider the ESG issues which affect us all, our communities and the planet.

What is responsible investment?

This is when investment managers use one, or a combination of different approaches to:

- decide which companies to invest in
- analyse ESG risks and opportunities a company may face, to help better manage risk and to help their funds achieve sustainable long-term returns (although remember that the value of all investments can go down as well as up)
- offer funds aiming to achieve specific ethical, environmental or social goals
- use their role as an investor in companies to encourage better ESG conduct and behaviours

The different approaches used to invest responsibly

ESG incorporation

Investment managers can use ESG factors to help analyse how a company may perform, as well as in the design of individual funds.

ESG integration

A process used to analyse a company's approach to ESG to help spot opportunities and manage risks. This doesn't screen in or out investments based on ethical themes, so investments that could be seen as negative may still be included.

Can be applied across all actively managed funds

Screening

Funds that 'exclude negative/include positive' investments based on ethics and values.

Includes ethical funds

Thematic

Funds aiming to achieve a financial return alongside a specific environmental or social outcome.

Includes impact funds

Stewardship

Investment managers can use their role to influence positive change in the companies they invest in.

Active engagement

Regularly talking to companies they invest in to understand their ESG activities and risks, and to encourage better conduct in these areas.

Proxy voting

Using voting rights on behalf of investors to encourage good management of matters such as governance, tax practices and climate change.

Can help encourage better sustainability and promote the long-term success of a company

The visual above is based on the outline of responsible investment from the United Nations-backed Principles for Responsible Investment (the PRI) but using our own words to help explain each approach. Find out more about these approaches on the next page.

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Using ESG to help manage risk and to provide funds to suit your values

Looking at ESG factors can help to manage investment risk

How a company manages its ESG activities or practices can indicate its overall health and quality – and its potential returns for investors. That's why investment managers will look at the actions a company takes (or doesn't take) in the three ESG areas to see if there are likely opportunities, or risks, on the horizon.

This can help an investment manager spot problems missed by more traditional risk analysis – and to better value what they're investing in.

An investment manager will analyse a company's practices in the following categories:

Environmental: a company's impact on land, sea, air, wildlife, plant life and the climate. Managers might analyse a company's waste disposal, how much energy they use, land development and carbon footprint.

Social: a company's relationship with people; its employees, suppliers and the communities in which it operates. A manager is likely to consider a company's approach to human rights, labour practices, supply chain issues and local communities.

Governance: the issues that affect or could affect the successful management and processes of a company. Managers may look at executive leadership, remuneration and strategy setting, operational and financial due diligence.

ESG analysis helps uncover risks and opportunities affecting returns to investors. So ESG is important to all investors – not just 'ethical' investors.

There's a choice of funds with specific ethical, environmental and social goals

There's a wide range of funds that aim to achieve a financial return alongside a specific ethical, environmental or social outcome. These types of funds are often described as using 'screening' or 'thematic' approaches.

The broad types of funds are below. While some funds will clearly screen in/out certain investments, or follow a theme, others will use a mix of these approaches depending on their objective.

Ethical funds: These tend to avoid investing in companies connected to activities like weapons, animal testing and tobacco (negative screening), or look for companies which contribute positively to the environment and society (positive screening). Some funds will use a combination of negative and positive criteria.

Impact funds: These follow themes, investing in companies intending to make a positive – and measurable – contribution to the environment or society. These companies solve problems through products, services and business operations, for example, renewable energy, affordable housing and accessible education.

Sustainable/socially responsible investing (SRI) funds: Invest in sustainable companies which balance their business interests with the effect they have on the environment and the community.

Faith-based funds: Invest according to certain religious principles or laws. An example is Shariah investing, which aligns its investment principles with Islamic law.

Are you interested in investing responsibly?

Please speak to your financial adviser to find out more. They can help you find the right investments to suit your financial goals and personal preferences.

Remember, the value of all investments can go down as well as up, and could be worth less than originally invested.

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