Looking Towards the Future

Discussing ESG With Your Clients

What is ESG? Is it just a fad?

How should I position ESG to my clients?

What effects can ESG have on returns?

Where can I prioritise ESG in my business?

With so much ambiguity around ESG, it's hard to break through the noise.

Environmental, social and governance (ESG) issues are often emotive and complicated, and investment trends can be fast paced. At Blackfinch, we are continuously strengthening our approach and understanding so that we are better placed to educate and support our partners.

In This Guide

Introduction	04
Defining the E, S and G	06
ESG Investment Approaches	08
Myth-busting	10
Preparing for Clients	14
Putting Words into Action	18
Supporting You on ESG	19

By adopting ESG strategies, the world can be a better place, with companies generating stronger earnings and dividends, and investments delivering higher returns.

ESG investing has been around in some form for decades, but the shift in favour of ESG in the last 18 months has been significant. This growth has happened against a backdrop of a coronavirus pandemic, disturbing reports of a global climate emergency, critical levels of plastics in our oceans, and demonstrations against social injustices and inequality.

Consequently, clients are increasingly aware of the need for investment providers like Blackfinch to invest their money responsibly, and in ways that support global sustainability goals. Except for some notable exceptions, most financial services providers claim to have always had a shared goal of investing responsibly. The difference now, and increasingly in the future, is that investment providers must demonstrate that their underlying investment paths focus on ESG standards.

As a result, the remit for investment providers will be far broader than just making ethical or 'green' products more readily available, or using marketing ploys to 'greenwash' their product ranges.

The investment landscape is changing rapidly in response to ESG-related issues, on several levels, including government-mandated action, stock exchange listing requirements and public understanding. For example, in February 2021, the UK Government signed up to the International Platform on Sustainable Finance, and new legislation is expected in early 2022. Also, the Financial Conduct Authority (FCA) is increasingly focusing on ESG in relation to financial advice, and exploring how the asset management industry can contribute to meeting climate change goals identified in the 2015 Paris Agreement.

As an ESG investor founded on evolutionary principles, Blackfinch has grown with ESG trends. We know it takes resources and commitment to incorporate appropriate standards and principles to develop a true ESG-focused organisation.

We also recognise there is still some immaturity in the marketplace, and that ESG brings an added layer of complexity for advisers and their clients.

Defining the E, S and G

Environmental

Investing with consideration for the environment. Attention is focused on how a company manages the environmental impacts of its operations and products. This includes addressing the climate emergency, water use, reducing pollution, sourcing raw materials and using clean energy sources.

Social

Investing with consideration for human and labour rights, equality and diversity. Attention is focused on how companies work in their communities, recruit and develop their employees, as well as how they protect and enhance safety and wellbeing. Consideration can also extend to whether companies expect high standards from their suppliers.

Governance

Investing with consideration for strong business ethics and board practices including executive pay. Attention is focused on how a company builds its management structure and engages with different stakeholders, particularly looking for evidence of transparency and integrity in areas such as tackling corruption.

The three ESG categories should not be viewed in isolation, as they are often interconnected.

For instance, a company's poor safety record can be a precursor to environmental incidents, pollution and consequent fines, damaging the company's community relations and its reputation.

ESG Investment Approaches

ESG investing considers environmental, social and governance factors alongside traditional financial factors in the investment decision-making process. However, ESG investing covers several practices.

Active Ownership
The use of share ownership and shareholder rights to positively influence the activities and behaviours of investee firms.

Ethical
Sometimes known as 'values-based investing' it selects investments based on ethical or moral principles and applies exclusionary criteria, such as avoiding companies involved in the sale of military weapons or equipment.

Green
Promotes environmentally-positive businesses, such as renewable energy companies.

Impact Investing
Investments aiming to have a measurable positive environmental or social outcome, such as encouraging female empowerment.

Responsible Investing
A broader version of specialist sustainable investing, this area also crosses over with the Engagement approach. Some funds may look to avoid some sectors or industries on sustainability grounds.

What are the main approaches to screening investments for ESG?

Generally, investment managers screen for ESG factors in two ways: positive screening and negative screening. At Blackfinch we define these as:

Positive Screening
This involves actively seeking to invest in companies that show strength in ESG factors. It means managers can select firms with examples of positive environmental products and socially responsible business practices. Crucially, it enables managers to not only analyse ESG leaders, but also ESG 'improvers' – companies making a material effort to improve their ESG management and building towards a more sustainable future.

Positive screening can also include adopting a 'best-in-class' approach. Managers can identify and include firms operating in potentially controversial areas such as tobacco, oil production or mining, that are making every effort to offset negative factors. As such, they may be ESG leaders in their sector. Positive screening allows for analysis on this relative rather than absolute basis. Investment managers can then select firms on this basis and will often engage with them to help improve further.

Negative Screening
This involves actively screening out investments in often controversial sectors or areas, regardless of how well they score on relative ESG factors. It won't allow investment in ESG 'improvers' until they've demonstrated improvement. This approach can often include supply chains too. For example, it may exclude investment in a supermarket, because the supermarket sells tobacco and alcohol considered damaging to health. Negative screening criteria can also be based on international treaties or principles such as the UN Global Compact.

Myth-busting

Despite the strong growth in ESG investing in recent years, some common myths persist.

MYTH NUMBER 1

‘ESG is just a fad’

While ESG investing has been around in some form for decades, the recent pace of change has been remarkable. This is reflected in the growth in public awareness in sustainable lifestyles and social justice causes driven by high profile individuals, organisations and social media campaigns.

Leading companies recognise that ESG is here to stay, and that a strong ESG proposition can safeguard their long-term success. Managing ESG risks and identifying opportunities can:

- lead to growth in customer bases and markets
- reduce operational costs
- prove attractive for retaining the best employees
- generate greater investment potential

ESG factors are increasingly being incorporated into government legislation and financial industries worldwide. In the UK, new legislation around responsible investing is expected to be announced in 2022.

Furthermore, ESG offerings from investment managers have increased exponentially in recent years and continued growth is expected.

MYTH NUMBER 2

“Incorporating ESG factors brings lower returns”

Investing in companies that prioritise ESG considerations in their management responsibilities can lead to superior returns, and there is a strong correlation between companies looking to improve their ESG management and share price performance.

At Blackfinch, we believe that companies demonstrating, or working towards, the highest of ESG standards will be the winners of the future. Conversely, companies that score poorly on ESG factors are more likely to suffer reputational and operational risks as well as shrinking customer bases.

MYTH NUMBER 3

“ESG is targeted for younger investors”

While younger investors have driven this interest, ESG is increasingly a focus for investors of all ages. Environmental campaigns such as those highlighted by Sir David Attenborough can reach all generations. This is reflected in more clients interested in passing on more of their wealth to children and grandchildren to protect their future.

Additionally, even clients that do not have strong ESG preferences still wish to take advantage of superior long-term returns. Companies looking to improve their ESG credentials are more likely to benefit from increased profit generation and decreased business risk, and will likely return sound profits.

Questions surrounding ESG are increasingly being incorporated into most client fact-finds so advisers will find themselves having conversations on these topics more frequently. It is likely that clients of all ages will show an interest.

Preparing for Clients

ESG definitions can be confusing, which has led to misunderstanding and misconceptions about its implementation in financial services.

ESG investing is not just an exercise in doing good things in consideration of clients' investments. It is also about having a rigorous due diligence process that identifies potential risks that could have negative effects on sustainability and investment returns. Also, ESG should not be used as a marketing ploy, or 'greenwashing' that can give a false impression of a company's credentials.

The following information can help to ensure that you're better prepared to answer questions from clients. The goal is always for you to be confident that your recommendations and advice are appropriate to the client's position and views on ESG

Does ESG integration create limitations?

No, ESG integration doesn't mean that:

- ✕ Investment in certain sectors, countries and companies is prohibited
- ✕ Portfolio returns are sacrificed to perform ESG integration techniques
- ✕ ESG considerations override investment decisions and traditional financial factors are ignored

ESG integration means:

- ✓ Businesses can enhance their existing processes and policies
- ✓ Investment decisions identify companies that wish to behave responsibly in terms of ESG, and those that do not
- ✓ Increased transparency on company practices to the benefit of employees, customers and investors

Isn't ESG just reflective of a more ethically-focused society?

ESG goes beyond ethical investing. It is about investing with appropriate consideration for a company's impact on the environment, the community and society, its staff and stakeholders, and its own internal management. This broader approach is important in helping to create a more sustainable world.

It is important to consider that, while certain aspects of ESG investing have always been part of the investment process, the level of understanding, and data availability, of ESG factors has grown over time. As a result, the breadth of factors investment managers must consider as part of ESG analysis has grown considerably, and will continue to do so.

What is Greenwashing?

Greenwashing can take different forms, but it is essentially applying a public relations 'spin' to an ESG commitment or performance. Companies may market themselves or their products as environmentally-friendly or 100% sustainable in order to attract customers, while in reality its 'green' credentials have been overstated. Companies may also use this as an attempt to cover-up unsustainable corporate agendas and policies. Whether deliberate or unintentional, greenwashing undermines trust.

Within investment management, greenwashing may be used to lure investors into believing their money is being invested in line with ESG factors, when they may only form a token part of the investment analysis. Identifying greenwashing examples is not always a straightforward process. It can require a high degree of analysis to uncover the authenticity of a firm's ESG credentials. Advisers and clients should be wary of any business they suspect of greenwashing, and it's essential to demand full transparency from an investment manager.

Putting Words into Action

At Blackfinch, we take our own ESG commitments and credentials seriously. That's why we're a signatory to the UN Principles for Responsible Investment, placing us at the heart of a global community seeking to build a more sustainable financial system.

We are continuously seeking to improve our own ESG approach and performance through updated policies and strategic oversight, including wellbeing and green initiatives for our employees.

PRI Principles for Responsible Investment

Supporting You on ESG

We're here to help you break through the noise. Look out for future updates and supporting materials.

If you need further information, please get in touch with your Blackfinch representative or use our general contact details:

01452 717 070
blackfinch.com
enquiries@blackfinch.com

ESG
Committed