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Standard Life
There's a lot to look forward to

Responsible investment: the basics

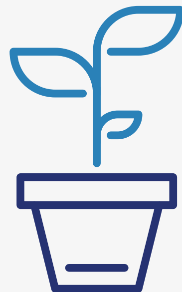
Incorporating environmental, social and governance (ESG) issues into investments

There's lots of choice for people who want to invest in ways that consider the ESG issues that 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 what 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 a steward of investments to encourage better ESG conduct and behaviours within companies



The different approaches used to invest responsibly

ESG incorporation

Investment managers can use a combination of three broad approaches to include ESG in both their overarching investment processes, and in the design of their individual funds.

ESG integration

A process used to analyse a company's approach to ESG to help spot opportunities and manage risks.

Can be applied across all 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

As steward of an investment, an investment manager can influence positive ESG change. They do this using engagement and voting rights.

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.

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ESG incorporation: adding to traditional investment analysis and fund choices

ESG integration 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 screening and thematic approaches

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.

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

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