Decoding Responsible Investing and ESG

The key buzzwords you need to know

Responsible Investing (RI) has been capturing greater attention with clients and practitioners alike. With this growth has come a plethora of new, and often confusing and conflicting terminology. To demystify this increasingly relevant space, this paper delivers a unified framework for understanding the RI universe.

- **Responsible investing (RI)** is the broad umbrella in the space. All other elements fall under this blanket term, in our view. Meanwhile, **Environment, Social and Governance (ESG) factors** are a framework breaking down the concept of sustainability into key environmental, social and governance issues, such as the following:

Environmental	Social	Governance
• Climate change • Water management • Pollution	• Labour standards • Human rights • Health and safety	• Executive pay • Board structure • Business ethics

- **Sustainable investing is a subset of RI**, focusing investment on companies that are making a positive contribution in addressing social and environment challenges. Notice the difference: while it is usual to refer to a sustainable fund as an investment vehicle, ESG factors simply provide a language for articulating the fund's priorities – they are not themselves typically an investment.
- **Thematic Investing** is strongly related to sustainable investing, and focuses on specific ESG issues by investing in solutions which address them. Examples might be funds related to women in leadership, cybersecurity, or renewable energy.
- **Ethical investing,** on the other hand, can be considered the counterweight to sustainable investing, in the sense that it uses negative screens, or exclusions, to eschew firms with an adverse social or environmental impact, and typically avoiding "sin" sectors. The distinction between an inclusive or exclusive approach is an important one for asset managers to consider when establishing their investment objectives.
- **ESG integration** is one of two strategies that can be applied across any 'sustainable', 'ethical' or completely mainstream portfolio. It simply refers to the inclusion of an understanding of the ESG issues affecting a company within the investment analysis, to ensure those issues are fully reflected in the valuation.
- **Engagement is the other strategy that can be widely applied across portfolios.** This means entering into a dialogue with companies after investment, to support and encourage positive change in the management of key ESG issues.
- **Impact Investing** is investing with the disclosed intention of generating and measuring social and environmental benefits.

The spectrum of responsible investing

Traditional Investing → Ethical Investing → Sustainable Investing → Thematic Investing → Impact Investing

BMO's Philosophical Approaches

Responsible, sustainable, and engagement products have a common investment philosophy, built around three tenets: "Avoid, Invest, Improve"

- Apply exclusions to Segregated Mandates on a case-by-case basis
- Leveraged recognised index providers to deliver beta within an ETF
- **Responsible** branded products apply explicit exlusions
- **Sustainable** branded products seek to make a positive contribution to society and the environment
- **Engagement** funds seek to target and maximise BMO's recognised capabilities in engagemnt

BMO Global Asset Management

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