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Sustainable Investing 101

An introduction to investing with purpose

With the threat of climate change looming larger, sustainability has become a business imperative – and a fast-growing investment category.

Sustainable investments now represent more than one-third of all assets in five of the world's biggest markets. According to the Global Sustainable Investment Alliance, sustainable investments totaled $35.3 trillion during 2020, an increase of 15% over the previous two years.[1]

For individual investors, sustainable investing offers potential benefits. If you're new to this space, here are the basics you should understand.

WHAT IS SUSTAINABLE INVESTING?

In broad terms, sustainable investing refers to investing in companies or funds that have positive environmental, social and governance (ESG) metrics. However, sustainable investing lacks a firm definition because its guidelines and objectives vary widely among funds. What makes an investment or financial product "sustainable" is somewhat up to interpretation.

For some, sustainable investing might mean investing only in enterprises, organizations and funds that deliver both financial returns and a measurable social and environmental impact. For others, it might mean avoiding companies that have a net negative impact or sell products or services that clash with personal values (think: firearms, tobacco, casinos). Still others will prioritize specific aspects of ESG metrics, such as reducing greenhouse gases, governing with transparency and accountability, or representing diversity and equity on corporate boards.

Sustainable investing is often viewed as an umbrella term for related investment approaches such as impact investing, socially responsible investing, ethical investing, principles-based investing and ESG investing. Again, the guidelines and objectives for these approaches vary.

WHY WOULD AN INVESTOR CHOOSE SUSTAINABLE INVESTMENTS?

Sustainable investing offers a way to align your personal values with your investment strategy. For example, you might choose to invest in the clean energy sector because you're concerned about climate change, or you might direct your investments toward woman-owned businesses because you care about gender diversity.

5 QUESTIONS TO ASK BEFORE INVESTING

- ? What are your personal values and how do they relate to ESG factors?
- ? What does "sustainable" mean to you?
- ? How does your advisor construct a sustainable investment portfolio? What metrics do they use? What outcomes do they strive for?
- ? What options do you have for sustainable investing? What are the pros and cons of those options, both in terms of financial performance and ESG outcomes?
- ? What is your goal for sustainable investing?

[1] Global Sustainable Investment Alliance. "Global Sustainable Investment Review 2020." http://www.gsi-alliance.org/. Accessed March 29, 2022.

There are also practical reasons for targeting sustainable investments. For example, companies that prioritize certain ESG factors may have lower costs and greater operational efficiency than their industry competitors. They might have more opportunities for growing their customer base or entering new markets. And they may have reduced risks for reputational damage or better strategies for safeguarding against climate risks. While the financial performance of sustainable funds varies, data indicates expense ratios for many ESG funds are on par with those of traditional funds.[2]

WHAT ARE SOME OF THE ESG METRICS USED TO EVALUATE SUSTAINABLE INVESTMENTS?

E

Environmental metrics look at factors related to a company's impact on the environment. These include carbon emissions, energy efficiency, pollution/air quality, clean energy technologies and use of natural resources or hazardous chemicals.

S

Social metrics look at factors related to a company's social impact. These include labor relations, diversity agendas, workplace health and safety, community engagement and relations, human rights issues, hiring and inclusion programs, and charitable endeavors.

G

Governance metrics look at factors related to how a company is managed or governed. These include board oversight, executive compensation and diversity, business ethics, shareholder rights, political contributions, transparency and disclosure practices, and conflicts of interest among stakeholders.

WHAT ARE POTENTIAL DRAWBACKS OF SUSTAINABLE INVESTING?

When it comes to ESG metrics, accounting and reporting standards remain inadequate. This, combined with a lack of government regulation, means that there is no clear classification for what makes an investment sustainable.

NEW GLOBAL STANDARDS ARE COMING

ISSB

In November 2021, the International Sustainability Standards Board (ISSB) was founded to develop new guidelines for sustainability reporting. The goal is to develop a global standard for sustainability measurement that integrates other existing standards and allows investors to make more informed decisions about sustainability risks and opportunities. ISSB expects to introduce the first set of standards sometime in 2022.

Without these guidelines, it is often difficult to discern the sustainability of investments in a way that allows investors to make apples-to-apples comparisons. It's also hard to hold companies accountable when their rhetoric about "being green" doesn't match up to reality.

As a result, investors risk putting their money into companies that are guilty of greenwashing. Greenwashing can show up in different ways. For example, a company might say it is committed to the environment but then misrepresent its sustainability footprint. Or an investment product might exaggerate its green positioning.

That said, these drawbacks shouldn't deter you from exploring sustainable investments further. Talk to your financial advisor about how sustainable investing might present new opportunities for you to do good while making a return on your investments.

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[2] Lynch, Katherine. "Where to Find Low-Cost ESG Funds." Advisor Insights, Morningstar, June 6, 2020, https://www.morningstar.com/articles/987495/where-to-find-low-cost-esg-funds. Accessed March 29, 2022.

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