

# Responsible investment terms explained



There are many ways to invest responsibly, from integrating environmental, social and governance (ESG) considerations into investment processes, to actively engaging with holding companies to effect positive change. However, the different types of responsible investment approaches, and the language that surrounds them, can often be confusing. The following booklet explains some of the most common terminology used in responsible investing that every investor should be familiar with.

## '2 degrees' or '2°C limit'

2°C is the widely accepted limit for global temperature increase (above pre-industrial levels) which may help to mitigate the worst effects of global warming, such as extreme weather events, water shortages or a global food crisis. The idea of this 2 degree limit has been around since the 1970s and was written into the Paris Agreement in 2016.

## Active ownership

Investors actively using their voting rights and/or directly engaging with company management on ESG issues, as well as wider matters of business strategy, to ensure the company's interests are aligned with their own. Active ownership efforts can help to reduce risk and enhance long-term shareholder value.

## Best-in-class

Focusing investments on companies that have historically performed better than their peers within a particular industry or sector, based on analysis of ESG factors. This typically involves positive or negative screening.

## Carbon Disclosure Project (CDP)

CDP is an independent, non-profit organisation that maintains a database of corporate climate change data, incorporating disclosures of individual organisations' greenhouse gas emissions and climate change strategies.

## Carbon footprint

A carbon footprint is the total measurement of an individual's or entity's greenhouse gas emissions. This can be split into Scope 1, Scope 2 and Scope 3 emissions which represent: direct emissions from owned or controlled sources; indirect emissions from the generation of purchased electricity, steam, heating and cooling consumed; and all other indirect emissions that occur in a company's value chain.

## Carbon neutrality

Carbon neutrality, or having a net zero carbon footprint, refers to achieving net zero carbon emissions by balancing a measured amount of carbon released with an equivalent amount sequestered or offset, or buying enough carbon credits to make up the difference. It is used in the context of carbon dioxide-releasing processes associated with transportation, energy production, and industrial processes, such as production of carbon neutral fuel.

## Carbon pricing

Carbon pricing is an instrument used to capture the external costs of emitting greenhouse gas into the atmosphere. Implementing a price on carbon provides an economic signal to those contributing to global emissions and encourages a change in behaviour to avoid increasing costs.

## Clean energy

Energy from non-polluting sources, including solar, wind and water.

## Cleantech

An investment theme, rather than an industrial sector, that may include investments in agriculture, energy, manufacturing and so on. Cleantech represents a range of products and services that either reduce or eliminate ecological impact, or require lower resource inputs.

## Climate change

Climate change is the overarching term used to describe the long-term shift in global climates associated with an increase in average global temperatures. These changes can include increased rainfall, increased desertification, more extreme temperature variations or higher frequency extreme weather events.

## Climate risks

Risks stemming from climate change that have the potential to affect companies, industries and whole economies. There are a range of business risks associated with climate change, including regulatory developments, growing natural resource scarcity and potential reputational damage. These are all risks that need increasingly to be proactively managed.

## Community investing/ Community impact investing

Providing capital to communities that are underserved by traditional sources of investment. Community investing generally provides credit, equity and basic banking functions to communities that would otherwise have no access.

## Conference of the Parties (COP)

COP refers to the annual Conference of the Parties which is the supreme decision-making body of the United Nations Framework Convention on Climate Change. The COP meets annually to review the implementation of the Convention.

## Corporate engagement

Using shareholder power to directly influence corporate behaviour or decision-making. This includes actions such as communicating with company management, filing shareholder proposals and proxy voting.

## Corporate governance

The procedures, processes and structures through which a company is directed and controlled. Responsibility for governance of companies lies with the board of directors, whose duties include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship.

## Corporate social responsibility/ Corporate responsibility (CSR/CR)

The idea that a business should take account of economic, social, environmental and ethical implications in the running of its operations. There are a number of impacts related to CSR, including risk mitigation, cost implications, brand image and competitiveness.

## Divestment

Selling or disposing of shares or other assets in certain investments. This is currently most readily associated with divestment from companies involved in the extraction of fossil fuels. Active ownership investors often view divestment as a last resort.

## Environmental, social and governance (ESG)

An investment approach that incorporates environmental, social and governance factors into the investment process.

## ESG fund ratings

ESG fund ratings provide customers or clients with an indication of ESG performance in relation to a specific fund, based on a chosen methodology usually provided by a third party. The score aims to quantify the ESG credentials of the underlying holdings and aggregate to a fund level score.

## ESG indices

ESG indices are indices which are constructed to track the performance of a universe of shares or bonds which have been selected based on specific ESG criteria. This can be through a process of screening or through the evaluation of companies based on ESG criteria.

## ESG integration

Including ESG factors as an integral part of the investment decision-making process, with this extra-financial analysis integrated into the overall analysis of a potential investment.

## Ethical investing

An investment philosophy guided by moral values, ethical codes, or religious beliefs, generally associated with negative screening.

## Extra-financial factors

Factors beyond those included in traditional financial analysis. In particular, environmental, social and governance considerations taken into account when evaluating the potential of an investment.

## Global Compact (United Nations Global Compact)

A corporate sustainability initiative, asking companies to align strategies and operations with universal principles on human rights, labour practices, environmental concerns and anti-corruption, while taking actions that advance societal goals.

## Governance factors

Governance factors are indicators as to how an organisation conducts itself and its business, including the procedures, processes and structures through which a company is directed and controlled.

## Green bond

A green bond is a method of debt raising which is used to fund new or existing projects which provide environmental or climate benefits. These can include renewable energy or green infrastructure projects.

## Green investing

An investment philosophy that considers the environmental impact of an underlying investment.

## Greenwashing

Greenwashing is conveying a false impression that a company, product or service is providing greater environmental benefits than is actually the case.

## Human rights

Human rights are the basic rights inherent to all human beings. These include the right to life and liberty, freedom from slavery and torture, freedom of opinion and expression and the right to work and education. The UN Declaration on Human Rights is recognised as the most common standard for human rights.

## Impact investing

An investment philosophy which supports companies that are working to provide significant societal or environmental benefit, in addition to generating a financial return.

## Impact measurement

The measurement of how companies' activities, products or services impact the world both positively and negatively.

## Integrated reporting

Company reporting that combines traditional financial reporting with sustainability/ESG reporting to indicate short, medium and long-term value creation in an economic, societal and environmental sense. The International Integrated Reporting Council is recognised as one of the core standards for such reporting.

## Microcredit

Small, typically low interest, loans to entrepreneurs who have little or no access to capital or financing, typically within developing countries.

## Modern slavery

The exploitation of vulnerable people who are trapped, dehumanised or have restrictions placed on their freedom through coercion, or mental or physical threat. This can take many forms including human trafficking, forced labour, sexual exploitation or forced marriage.

## Materiality

The level to which ESG factors positively or negatively influence a company's business model, value or reputation. In impact investing, this refers to the degree to which a company's products or services have a positive impact on society.

## Negative screening

A strategy of avoiding investment in companies that match pre-determined criteria – for example, if business practices are considered harmful to individuals or the environment.

## Over-boarding

Over-boarding occurs when a director takes on too many board roles, which results in an inability to effectively discharge their responsibilities or commit sufficient time to each board and company.

## Paris Agreement

The Paris Agreement resulted from the Paris Climate Conference (COP 21) in December 2015 and brought together all COP member nations in an agreement to undertake ambitious efforts to tackle climate change and limit the rise of global temperatures (from pre-industrial levels) to below 2°C, and ideally below 1.5°C.

## Positive screening (agree ‘best-in-class’)

A strategy of identifying investible companies that match predetermined criteria – for example, having a culture of strong corporate social responsibility.

## Proxy voting

Proxy voting allows shareholders to exercise their right to vote without having to attend company annual meetings. This can involve shareholders with voting rights delegating their votes to others who vote on their behalf.

## Renewable energy

Renewable energy is energy which is generated and collected from natural sources which are constantly replenished. Types of renewable energy includes solar, wind, hydro and geothermal heat.

## Responsible investment (RI)

As its basis, responsible investment (RI) is the incorporation of ESG factors into the selection and management of investments. Over time, RI has come to encompass a range of strategies including ESG integration, thematic investing, ethical investing, socially responsible investing, sustainable investing, green investing, community investing, mission-based investing and impact investing, among others.

## Responsible Property Investment (RPI)

RPI is an approach to property investing that recognises environmental and social considerations, along with more conventional financial objectives. It goes beyond minimum legal requirements, and includes improving the environmental or social performance of property through strategies such as energy saving measures.

## Screening

Screening is an approach taken to filter investment opportunities based on specific pre-defined criteria. These can be negative screens which remove companies based on an involvement in an undesirable activity or sector, or positive screens which filter companies specifically due to their involvement in beneficial activities.

## Shareowner/Shareholder advocacy

Using shareholder power to directly influence corporate behaviour or decision-making. This includes communicating with company management on environmental, social, governance, and transparency issues, filing shareholder proposals and proxy voting.

## Sin stocks

Companies that are deemed to be involved in unethical or immoral activities, which may include tobacco, gambling, adult entertainment and alcohol, among others.

## Social factors

Social factors make up the ‘S’ in ESG and focus on business activities, policies or culture which directly affect people, both within a company or in wider society. These can include labour rights, human rights, health and safety and supply chain management.

## Socially Responsible Investment (SRI)

Socially Responsible Investment (or Sustainable, Responsible and Impact Investment) is the process of integrating societal concerns, personal values or an institutional mission into investment decision-making. It is an investment process that considers the social and environmental consequences of investments within financial analysis.

## Socially screened or SRI funds

SRI funds integrate ESG analysis into the investment process, generally seeking to avoid owning companies that are deemed harmful to society or the environment, while seeking to own the most responsible companies with the highest potential for return on investment. Such funds may represent any asset class and a variety of different investment strategies.

## Stewardship

Stewardship is the act of being a responsible and engaged investor, pursuing an active investment policy through portfolio management decisions, maintaining a constructive dialogue with management and voting on resolutions at general meetings. Stewardship aims to ensure long-term protection and enhancement of the value of investments.

## Stewardship codes

Stewardship codes are a set of principles or standards which are established by regulators which help to set stewardship expectations for asset managers and asset owners and enhance the quality of engagement between investors and companies.

## Stranded assets

Stranded assets refer to the potential for fossil fuel reserves to become 'un-burnable' due to rising operational costs associated with carbon pricing, as well as increasing regulation and public pressure for alternative sources of energy.

## Sustainable development

The concept of meeting present needs without compromising future generations. It encompasses social welfare, protection of the environment, efficient use of natural resources, and economic wellbeing.

## Sustainable investing

Long-term investment in a company, asset or sector that makes a positive contribution to the environment, economy or society, in order to support or boost that positive contribution over time.

## Sustainability report

A report produced by an organisation to inform stakeholders about its policies, programmes, and performance regarding environmental, social, and economic issues. Sustainability reports are usually voluntary, and are sometimes independently audited and/or integrated into financial reports.

## Thematic investment

Thematic investment involves selecting assets on the basis of investment themes such as climate change.

## Transition risk

The financial risks that could result from a company being unprepared for a shift in policy, technology or the law as the world transitions to a low-carbon economy.

## Transparency

The degree to which an organisation discloses essential information about its structure and operations, assigning responsibility and accountability to management decisions and company actions.

## UN Principles for Responsible Investing (PRI)

The United Nations-backed Principles for Responsible Investment initiative is an international network of investors working together to put the six Principles for Responsible Investment into practice. Its goal is to understand the implications of sustainability for investors, and support signatories to incorporate these issues into their investment decision-making and ownership practices. In implementing the Principles, it is hoped that signatories will contribute to the development of a more sustainable global financial system.

## UN Sustainable Development Goals (SDGs)

A set of 17 goals which seek to address the most challenging social, environmental and economic issues facing the world today.

## Values-based investing

Values-based investing is a style of investment which prioritises ethical beliefs and objectives alongside financial returns. □

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The views expressed in this document should not be taken as a recommendation, advice or forecast.

Please remember that we are unable to give financial advice. If you are unsure about the suitability of any investment, please speak to a financial adviser.

Please remember, the value of any fund's assets will go down as well as up. This will cause the value of your investment to fall as well as rise and you may get back less than you originally invested.

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