Approaches to ESG Implementation

September 5, 2017

With the majority of investors believing it makes sense to incorporate environmental, social, and governance (ESG) factors into investment decisions, and surveys highlighting significant growth in ESG adoption by both asset owners and consultants, let's look at approaches to ESG implementation.

The Global Sustainable Investment Alliance (GSIA) definitions of sustainable investment have emerged as a global standard of classification, according to GSIA's 2016 Global Sustainable Investment Review.

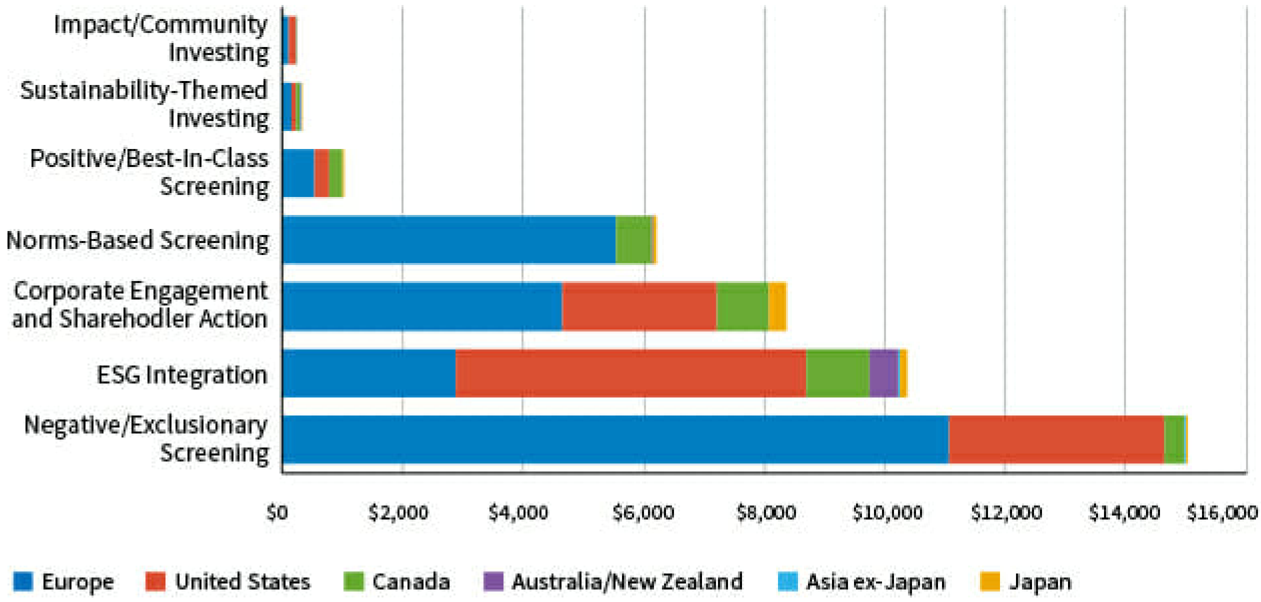
- **Negative/exclusionary screening:** The exclusion from a fund or portfolio of certain sectors, companies, or practices based on specific ESG criteria.
- **Positive/best-in-class screening:** Investment in sectors, companies, or projects selected for positive ESG performance relative to industry peers.
- **Norms-based screening:** Screening of investments against minimum standards of business practice based on international norms.
- **ESG integration:** The systematic and explicit inclusion by investment managers of environmental, social, and governance factors into financial analysis.
- **Sustainability themed investing:** Investment in themes or assets specifically related to sustainability (such as clean energy, green technology, or sustainable agriculture).
- **Impact/community investing:** Targeted investments, typically made in private markets, aimed at solving social or environmental problems, and including community investing, where capital is specifically directed to traditionally underserved individuals or communities, as well as financing that is provided to businesses

with a clear social or environmental purpose.

- **Corporate engagement and shareholder action:** The use of shareholder power to influence corporate behavior, including through direct corporate engagement (communicating with senior management and/or boards of companies), filing or co-filing shareholder proposals, and proxy voting that is guided by comprehensive ESG guidelines.

According to the GSIA, the dominant ESG adoption strategies, measured by assets, are negative or exclusionary screening and ESG integration, as shown below. Implementation via exclusionary screening has been more popular in Europe, while ESG integration has been the more prominent implementation method in the United States.

Assets by Strategy and Region (In Billions)



Source: 2016 Global Sustainable Investment Review

It is also interesting to see the growth in these strategies over the past two years ending December 2016. Growth has been strong across implementation methods, but impact/community investing and sustainability-themed investing stand out.

Certainly, this is an area on which tour high-net-worth and endowment/foundation clients are already focused.

Growth of Strategies, 2014-2016 (In Billions)

Strategy	2014	2016	Growth	CAGR
Impact/Community Investing	$101	$248	146%	56.8%
Sustainability-Themed Investing	$137	$331	140%	55.1%
Positive/Best-In-Class Screening	$890	$1,030	16%	7.6%
Norms-Based Screening	$4,395	$6,210	42%	19.0%
Corporate Engagement and Shareholder Action	$5,919	$8,365	41%	18.9%
ESG Integration	$7,527	$10,369	38%	17.4%
Negative/Exclusionary Screening	$12,046	$15,023	25%	11.7%

Source: 2016 Global Sustainable Investment Review. CAGR is compound annual growth rate.

In future posts, my colleague Vivian Thurston will describe our ESG journey at William Blair, providing some examples from the consumer sectors.

Disclosure:

This content is for informational and educational purposes only and not intended as investment advice or a recommendation to buy or sell any security. Investment advice and recommendations can be provided only after careful consideration of an investor's objectives, guidelines, and restrictions.

Information and opinions expressed are those of the authors and may not reflect the opinions of other investment teams within William Blair Investment Management, LLC, or affiliates. Factual information has been taken from sources we believe to be reliable, but its accuracy, completeness or interpretation cannot be guaranteed. Information is current as of the date appearing in this material only and subject to change without notice. Statements concerning financial market trends are based on current market conditions, which will fluctuate. This material may include estimates, outlooks, projections, and other forward-looking statements. Due to a variety of factors, actual events may differ significantly from those presented.

Investing involves risks, including the possible loss of principal. Equity securities may decline in value due to both real and perceived general market, economic, and industry conditions. The securities of smaller companies may be more volatile and less liquid than securities of larger companies. Investing in foreign denominated and/or domiciled securities may involve heightened risk due to currency fluctuations, and economic and political risks. These risks may be enhanced in emerging markets. Different investment styles may shift in and out of favor depending on market conditions. Individual securities may not perform as expected or a strategy used by the Adviser may fail to produce its intended result.

Investing in the bond market is subject to certain risks including market, interest rate, issuer, credit, and inflation risk. Rising interest rates generally cause bond prices to fall. High-yield, lower-rated, securities involve greater risk than higher-rated securities. Sovereign debt securities are subject to the risk that an entity may delay or refuse to pay interest or principal on its sovereign debt because of cash flow problems, insufficient foreign reserves, or political or other considerations. Derivatives may involve certain risks such as counterparty, liquidity, interest rate, market, credit, management, and the risk that a position could not be closed when most advantageous. Currency transactions are affected by fluctuations in exchange rates; currency exchange rates may fluctuate significantly over short periods of time. Diversification does not ensure against loss.

There can be no assurance that investment objectives will be met. Any investment or strategy mentioned herein may not be appropriate for every investor. References to specific companies are for illustrative purposes only and should not be construed as investment advice or a recommendation to buy or sell any security. Past performance is not indicative of future returns.