Zevin Asset Management
SOCIAL RESPONSIBILITY

Root Out Impact Washing in Your Portfolio

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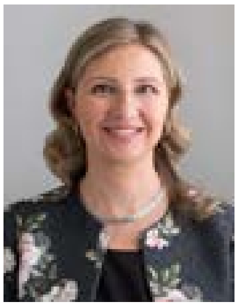

Time and time again, I am disappointed to see the actively blurred lines between environmental, social, and governance (ESG) investing, values-aligned investing, and impact. By conflating these concepts, investors who are intent on making a difference with their investments are often misled. Taken in by false promises of the positive change their investments can create, investors can be persuaded by impact washing to allocate assets to products or strategies that do not actively create change.

Anytime we deploy capital, we should be thinking about our impact. Know that investing is never without impact. Whether you are conscious of it or not, no investment is neutral — and you can choose what kind of impact to make with your investments and whether your impact undermines or amplifies your mission.

Investing with an ESG lens is not the same as creating impact with your investments or being values-aligned. If you find yourself using the terms ESG and impact investing interchangeably, you're not alone — these terms are often used interchangeably, sometimes on purpose by fund marketers. Let's break down how they are different.

ESG research and integration are parts of an investment process and are not necessarily tied to values, ethics, morality, or mission. ESG integration is a process by which investment managers look at a company to see how it is performing in various environment, social and governance measures, usually to mitigate risk and sometimes to understand a company's opportunities. Typically, analysts are only looking at ESG issues that are financially material (issues that affect risk and return, rather than the potential to create harm or good). ESG integration is a tool for value creation, not an ideology – a point that's missed by many of the politicians who are noisily trying to undermine the practice.

Using ESG integration in an investment process alone does not create impact. Although information gleaned from ESG research is vital to making good investment decisions, it doesn't create change by itself. Impact investing, on the other hand, must include the intention of generating measurable social impact alongside a financial return.

Know Your Buzzwords: Distinguishing ESG and Impact Investing in Public Equities

BUZZWORD	DEFINITION
ESG research and integration	The analysis of all material factors in investment analysis and investment decisions, including environmental, social, and governance (ESG) factors. —Principles for Responsible Investment
Impact investments	Investments made with the intention of generating positive, measurable social and environmental impact alongside a financial return. —Global Impact Investing Network
Greenwashing	The act of making false or misleading statements about the environmental benefits of a product or practice. It can be a way for companies to continue or expand their polluting as well as related harmful behaviors, all while gaming the system or profiting off well-intentioned, sustainably minded consumers. —Natural Resources Defense Council

Let the buyer beware: There are no regulatory definitions yet in the U.S. for ESG or impact investing products.

Let the buyer beware: there are no regulatory definitions yet in the U.S. for ESG or impact investing products. The onus is on the buyer to do their due diligence when selecting impactful investment products. Many ESG funds may reflect ESG themes such as climate change resilience but deliver little opportunity to proactively promote positive change. Through these funds you may also be investing in companies you aren't looking to support, such as fossil fuels, even if the funds are labeled "best in class," "sustainable," or "low carbon." This is greenwashing. Principles for Responsible Investment (PRI) offers resources for evaluating and comparing managers' stewardship practices and questions to ask investment managers.

Real Impact Comes from Additionality

"The secret of life is honesty and fair dealing. If you can fake that, you've got it made." —GROUCHO MARX

Impact investments have historically taken place in the private markets, where innovative approaches to some of our greatest problems often require long-term, patient capital. For example, when you invest in green bonds, your manager will typically buy them when they are issued which creates demand and there is a direct link back to the positive project that might not otherwise get funded. Likewise on the private equity side of things, the money you are investing goes directly to the firm who can choose to use your investment to help solve a pressing problem. With CDFIs, the invested capital goes directly to communities who otherwise might have a hard time accessing capital at fair interest rates, which reflects additionality. That is, your investment is linked to a positive outcome that otherwise would not have occurred.

The concept of additionality is particularly tricky in public equities. When your manager buys a share in a listed company, typically the money goes to the seller of the stock, not to the company itself. **Because of the lack of additionality, I do not believe investors can stock pick their way to impact in public equities.**

Selecting large companies for the products they sell, such as a climate fund that invests in renewable energy companies, is not **impact investing**. It may be aligned with your mission and that's enough for some investors but it's not impactful. Managers are including companies in impact labeled portfolios that don't even fit the bill. For example, if a company mentioned something about climate change in a sustainability report, then they could be marked as a climate change stock. I'm oversimplifying for effect but, sadly, not by much.

You may also have seen some public equity funds that claim that if you invest in them, you can avoid X tons of GHG emissions, save Y lives through disease treatment etc. I understand there is a thirst for this type of digestible, quantified reporting but please be very wary of very precise statistics that make claims of individual investors' real-world impact. Somewhere in the small print they might say that it is a metaphor but most clients, understandably, will take such reporting literally. Unlike investment returns where the marketing is highly regulated, there is not yet any third-party oversight regarding impact reporting, which creates room for this kind of misinformation. If funds could really do all they claim, the world would be saved tomorrow if we put enough money in.

The Bottom Line

Impactful work is happening in public equities through shareholder advocacy, something that investors have been pioneering through the Interfaith Center on Corporate Responsibility (ICCR) and Ceres for decades. Asset owners have been either doing the work themselves or increasingly outsourcing it to managers who can meet both their investment goals and are experts in changing corporate behavior through shareholder advocacy. Positive change, or additionality, happens when companies get pushed to take steps to meaningfully improve their behavior that they wouldn't have otherwise taken. Furthermore, the leading edge of shareholder advocacy centers the voice of impacted stakeholders rather than relying on the hubris of typically non-diverse investment managers to know what the appropriate solutions are.

As you examine your own portfolio, look for additionality. If the change is not apparent, that's your sign to reevaluate your approach and how your capital can create substantive, real world impact that furthers your mission.

*For more on our work and broader advocacy, check out our **resources** and latest **publications**, and join us on **LinkedIn** and **Twitter**. And please don't hesitate to contact us at **invest@zevin.com** with your questions, thoughts, and suggestions.*

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