

# Are You An Informed Investor?

## ESG Investing

*As climate change and social concerns have grown in recent years, many investors are becoming more conscious of whether a company in which they are investing has considered environmental, social and governance (ESG) factors. This is resulting in an investor-driven push to get corporate managers to pay greater attention to ESG issues. Some corporations are responding by altering their management philosophies and business plans.*

### What is ESG Investing?

ESG investing is a strategy in which an investor considers environmental, social and governance factors about a company or fund when making investment decisions.

Anyone can be an ESG investor simply by considering the following factors in their investment decisions:

**ENVIRONMENTAL.** Environmental factors reflect a company's impact on the planet, in both positive and negative ways. A company's environmental objectives may include its:

- Climate change policies,
- Greenhouse gas emissions goals, and transparency into how the company is meeting those goals,
- Carbon footprint, and
- Environmental benefits for employees such as cycling programs and environmental-based incentives.

**SOCIAL.** Social factors relate to company culture, and policies impacting customers and suppliers, both within the company and in society, such as a company's:

- Employee policies including sexual harassment prevention,
- Diversity and inclusion in hiring and in awarding advancement opportunities and raises,
- Ethical supply chain sourcing (examples: conflict-free minerals and responsibly sourced food and coffee),
- Mission or higher purpose of the business (or lack thereof), and
- Public stance on social justice issues, as well as lobbying efforts.

**GOVERNANCE.** The corporate governance component of ESG investing reflects how the business is run, including how the corporation is managed and how its board relates

to stakeholders. Many governance issues arise when insiders and/or board members act against the interests of shareholders. Such actions often are detrimental to the interests of employees and local communities. Many of these issues are eventually uncovered by securities regulators, but it often has taken activist shareholders to highlight the problems.

Some governance topics investors research and analyze are:

- Executive compensation, bonuses, and perks,
- Diversity of the board of directors and management team,
- Board and management conflicts of interest policies,
- Transparency in communicating with shareholders and the extent of shareholder litigation with the company, and
- Relationship and history with federal, state or provincial regulators.

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To learn more, contact the KENTUCKY DEPARTMENT OF FINANCIAL INSTITUTIONS

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## How is ESG Affecting the Investment Services Industry?

Growing numbers of investors want to understand how the companies in their portfolios are managing ESG risks. Investment companies are engaging with management teams to encourage corporate improvements to business practices such as capital allocation and improved disclosures.

Due to the increased attention by investors, broker-dealers and investment advisers are integrating a review of the ESG risks into their due diligence when advising investors. The financial services sector is now claiming to offer more ESG funds, and further claim to have thoroughly researched companies that incorporate these values. However, all ESG funds may not be created equal, and investors should be aware if an investment is right for them, and their risk tolerance.

## What Should Investors Think About When Considering an ESG Investment?

As an emerging trend in investing, investment companies may use very different methods for researching ESG factors. It may be hard to compare ESG factors within different funds. Here are some things to think about when considering an ESG investment:

**Quality of Research.** Sustainability reports prepared using respected sustainability standards.

**Focus on Details.** Be wary of corporate websites that do not contain sufficient detail to paint a complete picture. Note how the word “goal” is used. While goals are nice, concrete numbers and metrics provide a complete picture.

**Keep Informed.** Stay abreast of media reports related to how companies treat their employees and their lobbying efforts for or against social justice issues.

**Double-Check.** Use independent sources to check anything you read about from the company, look at the public filing documents, and websites that track how employees have rated the company. Follow up on the claims made the company.

## How to Protect Yourself

**Conduct a thorough check on the fund or investment you are considering.** ESG is an emerging area, so you will likely find many new funds or companies claiming to be ESG leaders. You should be check on track record of the company and management when it comes to ESG.

**Do not let anyone pressure you into making an ESG investment.** People who promote illegal investments often jump on emerging or popular trends to lure investors into their scams.

**Be sure to understand what you are investing in.** Seek independent, professional advice if you need help. Friends, family members, and colleagues sometimes suggest getting in on a new investing trend because they’ve heard or read about it somewhere. Purchasing an investment based on the suggestion of a friend or family member may be the wrong choice for you.

**Don’t invest more than you can afford to lose.** Investors sometimes feel a new trend or idea is worth going “all in” on. Stories of people making millions from owning a single company’s stock or a new idea can create this “fear of missing out” effect. In reality, those stories are rare and there are often special circumstances involved. Be sure to know yourself, your risk tolerance, and your financial situation before you make any investment.

**Consider consulting with a financial services professional or advisor.** When considering an emerging industry, it’s a good idea to enlist professional help. A financial professional familiar with ESG investing can give you insights into what to look for in an investment, and what to watch out for as well.

**Check with your securities regulator.** If you are concerned about an investment or individual selling an investment, contact your local securities regulator.

## The Bottom Line

*If you have interest in purchasing an ESG investment as part of your portfolio, before making any decisions, ask questions, do your homework and contact your state or provincial securities regulator.*