What I've Learned about Socially Responsible Investing
Socially Responsible Investing 3.0—Impact

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The challenge to define the word "good"

When it comes to socially responsible investing, one of the hardest challenges is defining what is "good." Each investor and organization has a different set of values by which they abide. For charitable giving and direct investments, it is simple because the individuals choose a single entity for a specific purpose. But when it comes to creating a public equity portfolio, managers have a more difficult task and need to consider not just the prospect of financial return but the client's ethical, religious, social, and personal beliefs.

To highlight the challenges a fund manager can face, a pension manager once told me a story about when he sold Disney from his fund. Disney had reached his price targets, and he thought the run up in the company stock had reached its limit. After he sold, a local religious group thanked him for removing the firm. They hadn't said anything before, but they were concerned with the firm's involvement in pornography. Like you probably are, the manager was a bit confused. When he inquired, he learned their issue was that Disney owned a small distribution company to get their cartoons and family films into theaters. The division also supplied movies to hotels, which of course supplied an "expanded" catalog of movies, including adult-themed films. Another investment manager described how a large potential investor (my understanding was it would be an eight-figure deal) pulled out because the global banks they worked with provided loans to small farmers and ranchers. The advisor had deemed this group important as they provide people with a source of protein for their diets, but the investor's granddaughter recently became a vegan, so he couldn't in good faith commit assets.

The Beginnings of Socially Responsible Investing

While there has been a long history of people donating to charities or privately investing in ventures that sought a specific purpose, deploying capital into public companies to make a difference while still generating a return is much newer concept.

The earliest efforts date back to the founding of Earth Day in 1970. Initially a small, cottage industry, over time investment advisors and funds emerged that targeted investors on an emotional and intellectual level. These initial investment vehicles typically followed one of two paths—employing a single negative screen or focusing on a single positive sector/theme. The early exclusionary funds were marketed as ex-tobacco, ex-weapons, or ex-South Africa during the apartheid era. More recently, advisors have pitched ex-fossil fuel portfolios as concerns have grown about global warming and its impact on the environment. In contrast, single sector funds enable investors to target a specific theme, such as firms involved with solar energy or wind energy or the water business. A number of strategies also sought to target religious or ethnic groups by incorporating negative screens, to align with the client's beliefs.

Redefining SRI

The mid-2010s saw the emergence of more activist investors and increased focus on adjusting the behavior of companies, which led to a shift in what SRI means. Although fundamentally, the overriding philosophy remained the same—to deploy investable assets and resources to achieve positive change, the acronym SRI evolved from "socially responsible investing" to "sustainable, responsible, impact" to reflect the "changing motivations and inspirations of responsible investors"[1] and the expanding options available to them.

Steve Schueth, president of 1st Affirmative, stated that SRI is, "Direct, invested capital to create a truly *sustainable* future, one that works for everyone. They want to own the most *responsible* companies, at least in part because those companies will play a significant role in creating the future we want to leave to our children and grandchildren. And they want to make money while having a positive *impact* on the world—at the same time. The different approaches likely means not much to some people, but for me, the difference is in attitude and intention between investors who want to do well *and* do good, as opposed to the old way of doing well *and then* doing good is a BIG DEAL. In fact, it's what's driving the growth and evolution of the...industry."

Researchers have documented demographic shifts and the transfer of an estimated $2 trillion in wealth to the children and grandchildren of senior investors over the next two decades. Surveys results demonstrate that more than 70% of younger investors, women, and those with a high net worth consider the importance of how they invest. Therefore it is important for financial professionals and investors to understanding and serve this growing market for SRI products.

The Rise of ESG: The Good and The Bad

To try to define what is "good," a number of firms focused their attention on ESG: environmental, social, and governance ratings. It has been estimated that more than 100 competing organizations have crafted differing methodologies to assign companies a score based on their answers to questions such as—Do they have a manufacturing waste procedure? What percentage of women are in key management positions? Each utilizing a varying set and number of questions.

Taking a detailed look inside a firm, ESG makes broad conceptual sense as it can identify risks in individual companies. Yet, there are a number of drawbacks to employing ESG ratings as the basis for stock selection in a passive fund vehicle. In particular, the ratings and analysis are typically proprietary and the details unavailable, making it hard for advisors and investors to select an ESG strategy that best aligns with their values. Additionally, some methodologies highlight best-of-breed and, therefore, can select the tobacco firm with the best ESG score and assign it a higher score than a company involved with wind energy. Likewise, since not all questions can be answered, sometimes companies receive a higher score by skipping questions. If you're confused, you are not alone. Many ESG firms have commented that their methodology is constantly evolving in order to resolve these issues.

In analyzing firms, one of the hardest part of evaluating a company is that a firm of any particular size can be both good and bad, and most often, at the same time. If a bank sets up false accounts for its clients, it is bad. If they then donate money for financial education, are they then good? What if the CEO then hosts a lavish party paid for with company funds? Are they now bad again? And for how long does that affect their rating? How fast does/can this rating change?

Even with these shortcomings, the concept of ESG provide new opportunities for investors. It does not take a stretch of the imagination to see a host of new funds emerging that market themselves as holding S&P500 stocks with a 3-star or better ESG rating or a growth fund with a 4-star or better companies. The questions for investors will be, why are they choosing a particular ESG strategy and does it conform to the values they are seeking?

Ultimately, the real value of environmental, social, and governance may reside with how funds vote their proxy. As more company stock is held inside ETF and mutual funds, voting based on ESG fundamentals and beliefs instead of solely on management suggestion will go a long way to improving how companies operate. As Steven Schueth commented, "proxy voting and shareholding resolutions are key levers for encouraging public companies to step up and become more responsible corporate citizens."

Socially Responsible Investing 3.0: Impact

Most clients at an intellectual level understand ESG, but it doesn't speak to them on an emotional or personal level. Focusing on the problems, and solutions to those problems, can do that. Even as the business of ESG evolves, the solution to investor needs may be impact investing. Having a more solutions-oriented conversation can engage investors on a deeper, more emotional level. It is difficult for an advisor to explain to a client why a company or a fund was chosen based solely on their having a 3.6 ESG score. Yet explaining to them that the company is actively involved in elder care and facilities that assist an aging population or that the firm focuses on clean water or expanding education, they feel a connection. They can show that they care about making a difference.

The public equity market for impact is still nascent but is rapidly gaining attention. According to data from impact analytics researchers at GIIN, the Global Impact Investing Network, approximately 94% of assets invested in impact is deployed via private equity ventures or in bond/debt offerings (such as school bonds, water facility improvement bonds, etc.) Private equity investing in specific projects or companies that have "boots on the ground" and that can link an investment to a direct outcome (i.e., a mosquito netting company expands into a region of Africa and malaria rates drop), provides the most positive feedback to investors. However, these types of opportunities can be difficult to find and are limited. Additionally, not everyone has the ability to learn about or access these types of deals. When minimum investments in a private equity or venture capital venture can be $500,000 or more, a lot of investors (and the dollars) are left on the sideline. In fact, of the $287 trillion invested globally, the global public capital markets represent $212 trillion.

To grow the assets which are invested in a socially responsible manner, one must target the public equity markets. To do so, two key questions must be addressed:

(1) How does one craft a methodology that focuses on solutions and the challenges affecting society in order to address the concept of "good"?

(2) How can one benchmark the impact results from an investment in a public security?

Emergence of United Nations Sustainable Development Goals

The UN SDGs were established as a means to gather information to determine exactly where, and into what, monies from government, charitable, and foundations were allocated. The philosophy being that if all organizations categorized their projects using this methodology, then we would know exactly how much money, for example, went into water-related projects in Africa vs. those in India or Southeast Asia. Likewise, one could also compare the level of resources devoted to eliminating poverty vs. improving regional health issues. The 17 SDGs defined by the UN can be found in Table A.

Table A: UN Sustainable Development Goals

Goal 1: End poverty in all its forms everywhere	Goal 5: Achieve gender equality and empower all women and girls	Goal 9: Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation	Goal 13: Take urgent action to combat climate change and its impacts
Goal 2: End hunger, achieve food security and improved nutrition and promote sustainable agriculture	Goal 6: Ensure availability and sustainable management of water and sanitation for all	Goal 10: Reduce inequality within and among countries	Goal 14: Conserve and sustainably use the oceans, seas, and marine resources for sustainable development
Goal 3: Ensure healthy lives and promote well-being for all at all ages	Goal 7: Ensure access to affordable, reliable, sustainable and modern energy for all	Goal 11: Make cities and human settlements inclusive, safe, resilient, and sustainable	Goal 15: Protect, restore, and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss
Goal 4: Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all	Goal 8: Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all	Goal 12: Ensure sustainable consumption and production patterns	Goal 16. Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels
Goal 17: Strengthen the means of implementation and revitalize the global partnership for sustainable development			

Although developed for statistical purpose, the SDGs are gaining attention as a policy and communications tool by a spectrum of organizations: including foundations, government, charities, institutions, and individual companies. By focusing on the varied challenges and solutions being developed around the world, policy makers and researchers can identify programs that achieve results and can be deployed into other areas, assess the effectiveness of investments in certain areas, and determine the best means to achieve direct results.

The one problem with these categories is there is no direct correlation between all of the SDGs and public equities. After all, *how do you define a company involved with the elimination of poverty?*

The SerenityShares Solution

To build upon this, SerenityShares led an effort which ultimately formed the basis of the SSI Impact Index (ticker: ICANNDX). Created by Scott Michael Sacknoff, a Wall Street-trained indexer who specializes in the design of equity benchmarks for investment funds such as ETFs (exchange traded funds), dozens of institutional and academic reports were analyzed (including the UN SDGs), and the landscape of existing investment products was surveyed, to design a new, practical methodology. The analysis resulted in 20 investable themes (see Table B) that address a variety of societal and environmental challenges that can benefit society and which, by definition, excludes areas of concern for many investors—such as tobacco, weapons, and fossil fuel exploration. Instead of just eliminating offending categories, the index constituents all have products or services that target the challenge even if the company did not intend it specifically for that purpose. This eliminated the subjective element of ESG as the selection criteria and put the focus on finding solutions to challenges not on a company's internal operations. Instead, ESG considerations are applied in proxy voting and shareholder resolutions.

Table B: SerenityShares Impact Categories

Environment and climate monitoring	Renewable energy production	Healthy, organic, natural foods
Forestry	Energy efficiency	Access to local health services
Oceans, seas, and marine environment	Information / knowledge access	Green transportation / technologies
Waste recycling and remediation	Community building	Assisting the elderly and disabled
Pollution control	Initiatives to bring cultures and people together	Small/micro enterprise loans and wealth transfer
Clean and sustainable water supply	Senior housing and care	Education and education infrastructure
Improving farming and agriculture yields	Safety and security	

Some companies operate in challenges that are more easily identified than others—renewable energy, water, and operating elder care facilities are three examples. Other challenges require a more in-depth understanding of the underlying issue.

Apple, for example, is an electronics systems designer, yet its devices provide a portable supercomputer that widely expands access to information. This is especially important in areas with limited physical infrastructure. The ability of farmers in developing nations, for instance, to research crop or pest information and access to the same information as western farmers, is vital to their ability to maximize crop yields and meet the nutritional needs of the local population. Likewise, being able to access medical information or remotely reach out to trained specialists benefits local populations as well.

Society also benefits from access to a number of services that rural and developing areas of the world lack—regular sanitation and recycling of materials, or local access to healthcare. Most of us take for granted having access to a firm like Walgreens or CVS and not needing to travel 50 miles or more to purchase supplies to deal with a medical issue or a Band-Aid and ointment to deal with a cut.

Comparison with ESG Methodology

ESG and Impact represent competing philosophies with similar goals. ESG focuses on looking inside each individual company's operations and assigning a score based on how effective they answer a defined set of questions. Methodologies can address 20 to 150 or more categories, collecting data which may or may not be publicly available or provided by the company, weighing those responses, and assigning a rating. Evaluations must be performed regularly as data is constantly changing.

Proponents believe that ESG scores can translate into positive returns…after all, reduced waste should translate into higher margins, and diversified boards or those that split the CEO and Chairperson roles, should lead to more constructive evaluation of strategies.

Impact focuses on a solution to an identified social, societal, or environmental challenge without regard to the company's internal operation. Turnover is more limited as a company's business plans and strategic direction is less likely to change frequently.

One of the critical elements of being a socially responsible investor is to influence the direction (hopefully) of the firms you own toward more positive social values. As SerenityShares has shown, it is possible to incorporate this vital function into a public equity impact portfolio by directing shareholder proxy votes to align environmental, social, and governance values.

Final Thoughts

Ultimately socially responsible investing can be used by investors and advisors in a number of ways, as:

1. A new core holding
2. Targeted exposure to reflect a desired personal belief
3. A replacement to an existing, broad market portfolio.

Sustainable, responsible impact investing is emerging as an important consideration for many investors. Employing environmental, social, and governance screens to proxy voting enables investors in impact funds to have a say in directing corporate actions. Compared to ESG ratings philosophies which can be complicated to explain to investors and hard to differentiate between which methodology to choose, impact investing focuses on the solution to a challenge and targets investors who want to make a difference at a deeper, more emotional level. As products across the spectrum of asset categories expand, investors and advisors have more options to aligning client seeking to make a positive impact while investing for return.