



# Sustainable Investing: Common Myths and Misconceptions



## Overview of myths:

1. Sustainable investing is the same as ethical investing
2. All sustainable investing approaches are essentially the same
3. Sustainable investing is a fad

Sustainable investing has experienced increased interest over the past few years, with a sharp acceleration in 2020 due to the COVID-19 pandemic and other high profile social issues, such as the Black Lives Matter movement. There are, however, some common myths and misconceptions among investors that may be new to modern sustainable investing approaches. This educational resource attempts to provide insight and clarification into what we believe are the most misunderstood issues.

## Myth #1: Sustainable investing is the same as ethical investing

While modern sustainable investing approaches have their roots in ethical investment strategies, there are important differences. Traditional ethical investing (also known as socially responsible investing, or SRI) is just one approach to sustainable investing, and typically involves strategies that prohibit investments in companies involved in certain industries that are considered unethical. Some of the more common areas of involvement include tobacco, firearms, controversial weapons, adult entertainment, and gambling, however, there are many others. These areas of involvement are highly subjective in nature, since different individuals will have different views of what they personally believe are “wrong”. Additionally, these exclusions may not involve factors that are financially material (particularly in those legacy strategies) and tend to focus only on social issues.

On the other hand, many modern sustainable investing approaches focus on financially material environmental, social, and governance (ESG) factors. Since they account for the materiality (or economic impact) of these ESG factors, they are typically less subjective than traditional SRI approaches. Advancements in reporting standards over the past few years and increasing investor demand for better ESG transparency has facilitated this shift in focus towards materiality. Lastly, the incorporation of material ESG factors into the investment process may not only help to identify material ESG related risks, but also uncover material ESG related opportunities. Modern sustainable investment approaches are where economic value intersects with society’s values (to varying degrees depending on the approach - see myth #2).

## Myth #2: All sustainable investing approaches are essentially the same

It is vital in understanding the different approaches related to sustainable investing. While standards and definitions continually evolve, there are generally six approaches to sustainable investing. Depending on an investor's motivation in considering sustainable investing, some approaches may be more relevant than others. In very general terms, the approaches further down the list imply a shift in balance towards societal values and less emphasis on economic value.



**ESG Incorporation** relates to the consideration of material ESG factors in the investment decision making process. For asset managers, this can be achieved within any of the three broad stages of the investment process: defining the investable universe, security level analysis, and portfolio construction. The primary goal of this approach is to improve longer term risk-adjusted returns.



### **Positive/Best In Class Screening**

focuses on companies and issuers that perform better than peers on one or more ESG related risk metrics. Similar to ESG incorporation, the primary goal is to improve longer term risk-adjusted returns.



**Negative/Exclusionary Screening** excludes securities, issuers, or companies from a specific investment strategy based on certain ESG-related activities, business practices, or business segments. The traditional SRI strategies discussed above typically fall into this approach, but negative screening may also be considered a modern approach if the focus is on financially material ESG factors.



### **Active Ownership and Engagement**

uses rights and position of ownership to influence issuers' or companies' activities or behaviors. Direct engagement is typically more successful for larger asset management firms controlling larger blocks of a company's shares. Smaller investors can join collaborative engagement groups to aggregate their influence. Goals are to influence a company's ESG related activities or to improve transparency in ESG factor reporting.



**Thematic Focus** strategies tend to invest in sectors, industries, or companies expected to benefit from long-term macro or structural ESG-related trends and typically focus on one area of interest. Examples include clean energy, sustainable resources, social diversity, and women in leadership. It is important to note that a strategy may score well in its area of focus, but score poorly on other ESG metrics.



**Impact** strategies aim to generate a positive, measurable social or environmental impact alongside a positive financial return. It is not uncommon that financial returns will trail market returns, as performance may be partially sacrificed to achieve the impact goal.

These approaches are not mutually exclusive and a product/strategy may employ more than one approach. They also typically complement traditional financial analysis and should not be considered a replacement.

### Myth #3: Sustainable investing is a fad

From an evidence point of view, the proliferation of sustainable investment strategies and strong fund flows into these products are easily researched through publicly available resources. Underlying these trends, however, is a more durable structural shift. There is an increasing acceptance among asset managers that ESG factors have a material impact on the longer term valuation of investee companies, and it is an asset manager's fiduciary responsibility to consider all material factors. In the past an impediment against this structural shift was the lack of consistent and meaningful ESG data, standards, and aligned frameworks to conduct proper ESG analysis. That argument is being gradually nullified as investors continue pressuring companies to report on ESG related factors that are aligned with increasingly accepted frameworks such as SASB (Sustainable Accounting Standards Board), TCFD (Task Force on Climate Related Financial Disclosures), and IRIS+ (the generally accepted system for impact investors to measure, manage, and optimize their impact). There remains plenty of room for improvement in this area, but the quality of data is rapidly improving.

At Empire Life, we believe sustainable investing is here to stay. We believe that corporate responsibility and a sustainable approach to business operations is a hallmark of quality. We also believe that strong corporate governance aligns management and shareholder interests, and that analyzing environmental and social factors can assist in identifying business models that may create sustainable value while reducing risk. Ultimately, we believe consideration of ESG factors are well on their way to becoming table stakes and "Sustainable Investing" will eventually be synonymous with "Investing" in general.



#### Sustainable Investing @ Empire Life

The recent launch of the **Empire Life Global Sustainable Equity GIF** is our debut offering incorporating a structural approach to ESG considerations. It adopts best-in-class screening and ESG incorporation as its main sustainability approaches, layered on top of our deep understanding of what makes a quality business an attractive investment. We believe this balanced approach between value and values represents the most natural progression of investment options within our diverse segregated fund family.

A description of the key features of the individual variable insurance contract is contained in the Information Folder for the product being considered. **Any amount that is allocated to a Segregated Fund is invested at the risk of the contract owner and may increase or decrease in value.** Please read the information folder, contract and fund facts before investing. Performance histories are not indicative of future performance.

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**The Empire Life Insurance Company**

259 King Street East, Kingston, ON K7L 3A8

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[empire.ca](http://empire.ca) [info@empire.ca](mailto:info@empire.ca) 1 877 548-1881

INV-3074-EN-06/21

