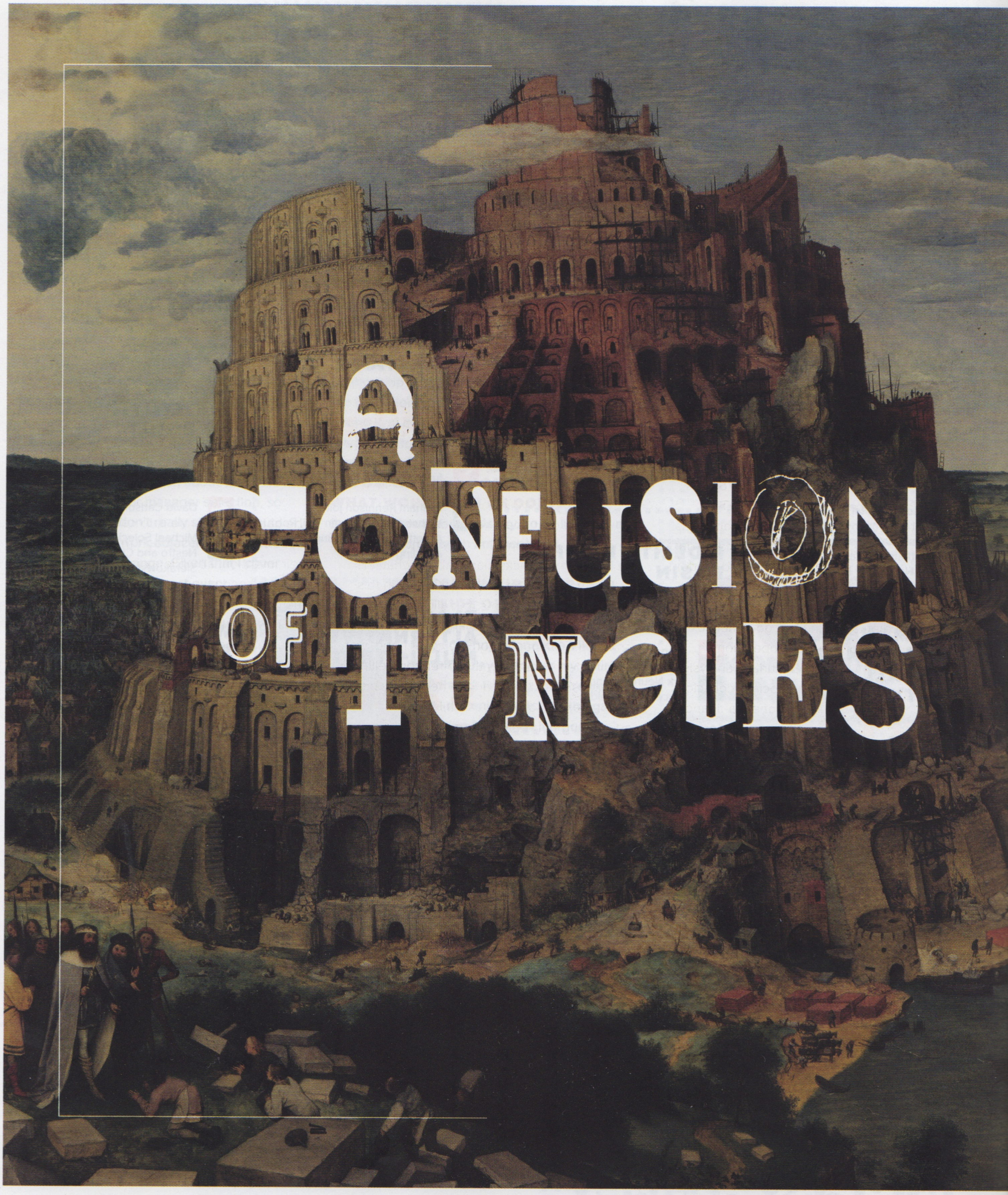
A CONFUSION OF TONGUES

The ESG marketplace is suffering from a problem of definition, not intention

MARK D. SLOSS

CHIEF EXECUTIVE, REGENERATIVE INVESTMENT STRATEGIES

The accepted wisdom is that we are awash in a sea of terms and acronyms that all more or less mean the same thing: ESG, sustainability, impact, SRI, socially conscious investing, values-based investing and so on.

But wait – somehow, the accepted wisdom is also that ESG and sustainability are economic disciplines examining the benefits of environmental, social and governance considerations on business operations, community services and securities analysis. By contrast, impact, SRI or socially conscious investing are seen as forms of extra-financial considerations that may come at an economic cost when incorporated into a portfolio.

Can both sets of assumptions be true? In short, yes. There are too many terms that started out meaning something precise but that have since been used and misused so interchangeably that they all mean specific things, the same thing and nothing at the same time.

Here's the problem: While the industry practitioners are trying to sort out how to define and engage investors in this market, the majority of asset owners – the people and institutions with the money – have already got at least a general sense of what they want, but not always the right language to articulate it. There is also a subset of asset owners who have highly evolved and extremely targeted expectations and are using these terms with precision to describe what they require, but the consultants and asset managers have confused and conflated the terminology to the point that even the most sophisticated investors have to dig many layers deeper to see whether an investment strategy actually aligns with their interests.

FINDING A LINGUA FRANCA

If you have customers who lack a shared language to explain what they want to buy and an industry that lacks clarity about what it is selling, you've got a problem. Clients in this space want investments that align with their needs, interests, missions and values. Asset and wealth managers, on the other hand, want to provide investments that offer compelling risk-adjusted returns and the necessary market exposures, in some cases while also addressing non-economic issues such as human dignity and environmental risk.

I have spent a fair amount of time in these pages digging into the importance of building intentions into the investment process. I want to pivot for a moment and examine the intentions of the client. Drawing from my own experience working with clients and their trusted advisors, I am yet to be part of a client conversation about ESG (or whatever you want to call it) where the client was purely interested in whether it provides a better risk-adjusted return. It might be a precondition of their interest – 'Give me ESG exposure but not at the expense of performance' – but it is not the driving motivation behind the conversation.

The intention, in its varying shapes and colors, is to address the relationship between the client's investments and environmental and human conditions. This might be about nothing more than establishing context – gaining an understanding of exactly what they own and what impact that has. Alternatively, the intention might be to do the least harm possible while primarily focusing on achieving financial objectives. It may even extend to investing in strategies that actively participate in improving these conditions. Or it might go all the way to using assets as a lever to change businesses, governments and market systems through investment and activism.

PUTTING THE PIECES TOGETHER

The gatekeeper's role is to connect the client with an investment solution that addresses their intention, all while maintaining the discipline and standards that should apply to all due diligence and evaluation efforts. It is time to throw out the word salad, because it has gone bad. The confusion over the jargon is creating a situation where stakeholders think they are talking about the same thing when using terms such as 'ESG' and 'impact,' when in fact they are not. We have to answer the fundamental underlying question: Do the intentions of the manager align with the intentions of the asset owner?

Of course, the advice-driven financial services business has solved problems like this before. It has managed to build an admittedly flawed but generally effective framework for profiling client risk tolerances and characterizing them in terms of an efficient asset allocation. Why can't the same happen in ESG?

So let's tear down this Tower of Babel. It's time for a similar universal starting point and a common lexicon in sustainable investments. ■