

ESG 101



ESG stands for Environmental, Social, and Governance. It is also called “sustainability” in many situations. Each pillar comprises a number of criteria that may be considered. E, for instance, can include a company’s use of energy and greenhouse emission management. S can be employee engagements and how a company manages its social and business relationships. G may include board management and risk oversights.

Here is our definition at Principal.

ESG at Principal



ESG Investing

Nowadays, more investors consider it important to incorporate these values and concerns into their selection of investments. As ESG investing has become more mainstream, people are recognizing that it does not have to mean sacrificing returns. In a business context, ESG can be about the company’s business model, i.e. how its potential negative impact.

An investment team’s ESG scoring process will compile relevant information and score specific metrics for investors to evaluate a firm’s collective conscientiousness for social, environmental factors and overall governance within the organizations.

Common Investment Objectives

There can be different objectives when it comes to ESG investing. MSCI has defined three common investor objectives or motivations when considering an ESG strategy: Integration, Values and Impact¹. Investors may pursue these objectives through different approaches. To name a few common ones, that can include best-in-class selection, exclusionary or negative screening, or impact investing.

Best-in-class selection¹: Preferring companies with better or improving ESG profiles relative to sector peers.

Exclusionary or negative screening¹: Avoiding securities on the basis of an organization or individual's values, standards and norms, or other ESG considerations.

Impact investing¹: Investing with the intention to generate measurable positive social or environmental benefits.

The Sustainable Development Goals²

While ESG definitions and investment objectives can be different, there are common goals that an investment vehicle can align with. The 2030 Agenda for Sustainable Development, adopted by all United Nations Member States in 2015, provides a shared blueprint for peace and prosperity for people and the planet, now and into the future. At its heart are the 17 Sustainable Development Goals (SDGs), which are an urgent call for action by all countries - developed and developing - in a global partnership.



An MSCI ESG Rating³

There are also investment results that we can track, one way is through third-party ESG ratings. An MSCI ESG Rating is designed to measure a company's resilience to long-term, industry material environmental, social and governance (ESG) risks. They use a rules-based methodology to identify industry leaders and laggards according to their exposure to ESG risks and how well they manage those risks relative to peers. The ESG Ratings range from leader (AAA, AA), average (A, BBB, BB) to laggard (B, CCC).



LAGGARD

A company lagging its industry based on its high exposure and failure to manage significant ESG risks

AVERAGE

A company with a mixed or unexceptional track record of managing the most significant ESG risks and opportunities relative to industry peers

LEADER

A company leading its industry in managing the most significant ESG risks and opportunities

¹ Source: MSCI. <https://www.msci.com/esg-101-what-is-esg>

² Source: United Nations. <https://sdgs.un.org/goals>

³Source: Source: MSCI. <https://www.msci.com/our-solutions/esg-investing/esg-ratings>

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