

## What's The Buzz About ESG?

### Understanding How ESG Works

Environmental, social, and governance (ESG) criteria are a set of standards for a company's operations that socially conscious investors use to screen potential investments.

- **Environmental:** Environmental criteria consider how a company performs as a steward of nature, including addressing climate change concerns and environmental issues within & beyond their industry.
- **Social:** Social criteria examine how it manages relationships with employees, suppliers, customers, and the communities where it operates, including diversity and inclusive hiring practices and promoting diversity at senior levels of management.
- **Governance:** Governance deals with a company's leadership, executive pay, audits, internal controls, and shareholder rights - providing more power to shareholders and treating the company's impact upon stakeholders in a more holistic sense.

### How Environmental, Social, and Governance (ESG) Criteria Work

To assess a company based on environmental, social, and governance (ESG) criteria, investors look at a broad range of behaviors. Environmental, social, and governance (ESG) criteria help investors find companies with values that match their own. Environmental criteria may include a company's energy use, waste, pollution, natural resource conservation, and treatment of animals. The criteria can also be used in evaluating any environmental risks a company might face and how the company is managing those risks.

**FOR EXAMPLE...** Are there issues related to the company's ownership of contaminated land, disposal of hazardous waste, management of toxic emissions, or compliance with government environmental regulations? These pose both a business concern in the form of cleanup costs and high legal expenses, and avoiding these risks also aligns with the values of new investors.

### A Demographic Shift

In recent years, investors have shown an interest in putting their money where their values are. That's why brokerage firms and mutual fund companies have started to offer exchange-traded funds (ETFs) and other financial products that follow ESG criteria. In 2018, investors held \$11.6 trillion in assets which have been chosen according to ESG criteria, up from \$8.1 trillion in 2016.

### Important Takeaways

Environmental, social, and governance (ESG) criteria are an increasingly popular way for investors to evaluate companies in which they might want to invest. Many mutual funds, brokerage firms, and robo-advisors now offer products that employ ESG criteria. ESG criteria can also help investors avoid companies that might pose a greater financial risk due to their environmental or other practices.

**Pros and Cons of ESG Criteria**

In years past, socially responsible investments had a reputation for requiring a tradeoff on the investor's part. Because they limited the universe of companies that were eligible for investment, they also limited the investor's potential profit.

More recently, however, some investors have come to believe that environmental, social, and governance criteria have a practical purpose beyond any ethical concerns.

By following ESG criteria they may be able to avoid companies whose practices could signal a risk factor—as evidenced by BP's 2010 oil spill and Volkswagen's emissions scandal, both of which rocked the companies' stock prices and resulted in billions of dollars in associated losses. As ESG-minded business practices gain more traction, investment firms are increasingly tracking their performance.

Financial services companies such as JPMorgan Chase, Wells Fargo, and Goldman Sachs have published annual reports that extensively review their ESG approaches and the bottom-line results.