The ABC's of SRI

What Exactly is the Difference Between ESG and Impact?

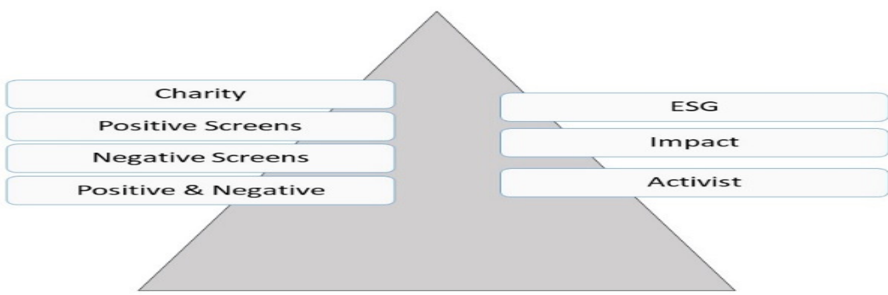
By Scott Sacknoff, CEO
SerenityShares Investments LLC

The Issue

Although products have existed since the 1970s, socially responsible investing is evolving and still can be considered a relatively new, albeit growth, industry. Many have been using SRI, ESG, and impact interchangeably, but in reality they are quite different. Having a clear definition of and understanding the differences between SRI, ESG, and impact will enable the financial industry to more effectively communicate with investors and, thereby, attract more assets and investments.

From its inception, SerenityShares has maintained the philosophy that "investing doesn't need to be complicated." Based on conversations with numerous professionals and individuals operating in this industry, we've drafted the following to provide some clarity to a complicated issue.

The Seven Elements of SRI



What Exactly is SRI?

SRI, the first term used in the field reflected the desire of investors to have some good come out of their investment resources. They chose not to just blindly invest based on technical or analytic methodologies but allocate into areas they felt were important—whether renewable energy after the oil crisis in the 1970s or by avoiding firms doing business with South Africa during its apartheid years. Ultimately, SRI became the top-level basket that all related activities and investment vehicles fall under.

Yet even the SRI acronym, has changed over time. Originally it meant: Socially Responsible Investing. Currently many refer the acronym as Sustainable, Responsible, Impact to "reflect the motivations and inspirations of responsible investors."[1]

Redefining SRI

Specifically, 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—[both] at the same. The different approaches many not mean much for some people, but for me, the difference is 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 SRI/ESG/Impact industry."[1]

© 2017 SerenityShares Investments, LLC 110817

Fundamentally though, the overriding philosophy has remained the same—how to deploy investable assets and resources to achieve positive change. This can be done in 1 of 3 ways:

- Choosing an area(s) of interest that you want to support
- Choosing an area(s) of interest that you want to avoid
- Using proxy votes and shareholder resolutions to encourage public companies to step up and become more responsible corporate citizens.

Understanding the Seven Elements

Charity	- Minimal to all investment levels - Automatic 100% loss of capital (donation, not an investment) - Directly target specific organizations / causes - No input into operations, unless significant donation levels
Positive Screen	- Targets a specific theme, sector, company (ie. solar, women in leadership positions) - Limited diversification, higher risk/return due to concentration
Negative Screen	- Identifies companies to invest in based on exclusionary factors - ie. ex-tobacco, ex-defense, or ex-South Africa during apartheid
Positive & Negative / ie. Religious Themed	- Depending on interpretation and point-of-view, employs positive and negative screens - Positive: Reflects personal values - Negative: Accomplishes this by employing exclusionary screens
Activist	- Acquires a significant ownership stake in order to challenge the status quo and improve some facet of an individual organization
ESG Environmental, Social, Governance	- Looks inside the operations of a public company and scores/ranks are assigned based on a series of metrics and/or questions - 100+ strategies exist— each rely on different methodologies - Scores are utilized to select firms or as an overlay to the portfolio selection process - Some strategies are non-exclusionary and looking for "best of breed"— and may not exclude sectors such as tobacco or weapons - Proprietary strategies make it hard to evaluate and compare across competitors - Numerous challenges for ESG ratings include low scores for unrelated activities (ie. a services firm not having a manufacturing waste policy) or how unanswered questions are handled when data is not available. A firm involved with recycling might be rated low for operating in a highly regulated industry while a weapons manufacturer might receive points for having women on their board
Impact • **Private Equity** • **Bonds/Debt** • **Public Equity**	- Focused on challenges and solutions to challenges. Companies are selected based on how they generate their revenues - Can be aligned with UN sustainable development goals - Three unique markets: o <u>Private equity</u> (including "boots on the ground"—1-on-1 problem solving that some refer to as "Deep Impact") o <u>bonds/debt offerings</u> (like school bonds and green bonds) o <u>public equity</u> solutions - Boots- on-the-ground and bonds/debt are easier to quantify the direct resultant impact—one reason why public equity solutions are just starting to emerge - Can employ ESG considerations in their proxy voting to steer companies toward more socially and environmental responsible policies

© 2017 SerenityShares Investments, LLC 110817

Additional Terms

SDG Sustainable Development Goals	- Established by the United Nations - Developed to categorize where and how money is being allocated by governments, charities, foundations, and investors - Emerging as a benchmark for impact portfolio assessment - Offers a common framework / clear tool on how to think about impact

Identifying the Preferred Solution

The reality is…there is none. There are benefits, drawbacks, and challenges with each. No one strategy is a solution for all investors and all asset classes. Each of the identified SRI concepts can have merit and is dependent on:

1. What the investor wants to achieve;
2. Why they want to achieve it;
3. What level of risk they are willing to accept; and the
4. Level of resources to be invested and their ability to access non-public opportunities.

Ultimately, no matter which option investors select, they should pay attention to proxy voting and shareholder resolutions as they are the key levers for encouraging public companies to step up and become more responsible corporate citizens.

Comparing the Elements

	Benefits	**Challenges/Limitations**	**Ability to Influence Management**	**Ability to define benefit to society**
Charity	All assets directed to a specific purpose	100% loss of principal, not an investment strategy	Depends on size of donations	Easy. Based on choice of charity.
Activist Investor	Target a specific company for a specific reason	Requires significant assets	Depends on the size of assets owned	Focus is on fixing a problem within an individual company
Positive Screen	Targeted to the specific beliefs of an investor	Lack of diversification in fund	Not a central part of the theme	Tied to the sector / subsector invested in
Negative Screens	Targeted to the specific beliefs of an investor	Varies and dependent on each investor's beliefs	Not a central part of the theme	Direct, specific to each investor's belief
ESG Ratings	Provides a look inside public company operations Can identify risks to investors of individual firms	Subjective, proprietary methodology. ESG ratings to select investments don't necessary reflect targeted values	ESG values may, or may not, necessarily be employed in proxy voting	Focus is on the company not a specific issue/ challenge
Impact	Focused on solutions to problems Ease of understanding selections and process Public and private options exist Can align w/UN SDGs	"Boots on the ground" and debt products easier to quantify then public equity Private equity requires significant assets and connections to identify available deals	Can employ ESG screens in proxy voting	Private equity, and bond/debt products easier to quantify than public equity.

© 2017 SerenityShares Investments, LLC 110817

What's Next for SRI?

In the coming years, interest in SRI investing will continue to grow as will the type and range of products available. It is imperative that financial advisors be knowledgeable of the many options available in order to best meet the needs of their clients.

1 Email correspondence with Steven Schueth, First Affirmative, Chair, SRI annual conference, 27 September 2017

© 2017 SerenityShares Investments, LLC 110817