ShareAction»

Investing for people and planet

A detailed overview of ShareAction's responsible investment definition

Why the world needs a new definition of responsible investment

Over the last few decades trillions of dollars of investments have powerfully shaped the world around us, both for better and worse. However, the investment system has been structured to ignore externalities and these investments have generally been undertaken without regard for their impacts upon people and planet.

The global investment system has the power to play a decisive role in fixing urgent crises from climate change and biodiversity loss to deep and unjust inequalities that threaten the fundamental stability of our society. To perform that role effectively, the world needs an ambitious, impact-driven definition of responsible investment to be adopted right across the investment system. In other words, it's time for a new definition of responsible investment that reconnects finance to society.

> Responsible Investment is a transparent approach, embedded throughout the investment process, that takes the negative and positive impacts on people and planet as seriously as financial risk and return.

This definition is intentionally aspirational. ShareAction recognises that there are significant barriers to fully realising it, such as existing interpretations of pension fund fiduciary duty. However, ShareAction believes that this is the definition of responsible investment the world needs. It is designed to push at the boundaries of what is done and doable within the current investment system.

However, even within the limits of today's investment system, there remains much more that investors could do. Our research on major asset managers and insurers highlights examples of leading practice on critical social and environmental issues, proving that it is possible to be far more ambitious than most in the industry are. ShareAction is launching a new guidance series on Responsible Investment Standards & Expectations (RISE) that will outline ambitious but achievable standards across specific responsible investment themes that investors can deliver on today.

It's time to move beyond ESG

Over the last decade, the global investment community has embraced ESG investing. This approach sees environmental and social factors considered insofar as they represent a material financial risk to investment returns. While ESG investing is a step in the right direction, the approach is too limited and narrow to make a real impact on problems created by corporate practice. ESG investing is facing legitimate challenges thanks to misleading claims by investment product providers as well a range of teething issues concerning ESG data, methodologies and reporting frameworks.

This is entirely consistent with the fact that the only responsibility for investors under an ESG-investing approach is to optimise financial returns within existing regulatory frameworks. ESG investing does not require investors to consider or take responsibility for the impacts of their investments on people and planet. The distinction between ESG as a financial risk factor and responsibility deriving from causation or facilitation of negative impact is often lost.

ShareAction's new definition of responsible investment challenges investors to move beyond ESG investing and to take real responsibility for how investments affect people and planet. Under this definition, responsible investors will take negative and positive impacts of investments as seriously as financial risk and return.

Responsible Investment should be grounded in environmental and social frameworks

There are already many widely accepted international conventions on environmental and social issues that can be used to design sustainability thresholds relevant to investment decisions. While there are some data and methodology challenges around these frameworks, they nonetheless provide a powerful resource for investors.

The Paris Agreement on Climate Change includes specific global temperature goals and the 2022 United Nations Biodiversity Conference (COP15) resulted in a landmark agreement to guide global action on nature. On social issues, the Sustainable Development Goals (SDGs) are already familiar to many investors. Specific labour and human rights are enshrined in frameworks like the UN Guiding Principles for Business and Human Rights as well as the following international agreements including, but not limited to:

- The International Bill of Human Rights (comprising the Universal Declaration of Human Rights of 1948)

- The International Covenant on Civil and Political Rights of 1966 and the International Covenant on Economic, Social and Cultural Rights of 1966

- The International Labour Organization's Declaration on Fundamental Principles and Rights at Work and related conventions

- United Nations instruments covering the rights of indigenous peoples; women; national or ethnic; religious and linguistic minorities; children; persons with disabilities; and migrant workers and their families

There are also global treaties on specific issues, like weapons, and country-specific laws like the UK's Modern Slavery Act. While investors routinely acknowledge and claim adherence to these powerful frameworks, their actual approaches to respecting them varies considerably. And the integrity of such claims is challenged when the principles of these frameworks are superseded by the prioritisation of financial return.

Defining characteristics of a responsible investor

ShareAction's definition of responsible investment is based on four interlinked characteristics

Responsible investment is a transparent approach

Responsible investors are transparent in how they assess and trade off impacts against financial risk and return. This is most critical for guiding decision-making in investment cases where negative impacts and financial returns are both high. Beyond capital allocation, responsible investors are also transparent on their stewardship with investees (including escalation) and approach to public policy advocacy. While disclosure around voting and engagement is starting to improve, transparency on the broader application of responsible investment including trade-offs remains inadequate and inconsistent. Greater transparency is vital to enable clients and key stakeholders to make informed choices.

Responsible investment is embedded throughout the investment process

Responsible investors take a long-term approach to investment decision-making that is consistently and systematically applied across the organisation, covering all asset classes, investment strategies and offered funds. Responsible investment requires forward-looking cultural change that applies across all organisational levels. Responsible investors also model the standards and behaviours they expect of their investee companies.

Responsible investment considers both positive and negative impacts

Responsible investors take responsibility for the full inventory of impacts of all their investments on people and planet, negative and positive. In some cases, avoiding negative impact requires only choice and intent and is not dependent on countervailing measures, for example on respecting human and labour rights. In other cases, reducing negative impact is dependent on actively investing in positive impacts to replace them, for example investing in low-carbon solutions to mitigate emissions. An important element of responsible investment is recognising when focusing on positive impacts is key to enabling the avoidance of negative impacts.

Responsible investment takes these impacts as seriously as financial risk and return

The fundamental challenge for responsible investors today is the tension between securing returns and avoiding negative impacts (or promoting positive impacts). It is not difficult to choose how to invest in cases where expected negative impacts are low while expected returns are high. Similarly, where negative impacts are high and expected returns are low, it's an easy decision. The testing question is the extent to which investors are able, and willing, to forego higher returns to avoid higher negative impacts.

This trade-off between expected returns and future negative impacts is critical. A responsible investor creates objective, coherent mechanisms to ensure such impacts are sufficiently considered against financial risk and return criteria. The assessment of social and environmental impacts should be informed by credible science-based frameworks or existing normative frameworks, as far as possible. Responsible investors set out how they calibrate return against impacts, including scenarios where such calibration could accept highly negative impacts, and the rationale for this calibration, as well as what negative impacts are to be avoided at all costs.

This approach directly informs decision-making regarding capital allocation, stewardship and public policy advocacy. Responsible investors apply these levers in combination to optimisehe effectiveness of their approach. They take a proactive role in public policy advocacy to allow wider considerations of negative and positive impacts by investors in decision-making.

Key questions answered

How does this definition relate to the concept of double materiality?

This definition is aligned with the concept of double materiality, which requires companies and investors to consider and report not only how sustainability issues impact upon financial risk, but how their activities impact upon people and planet.

How does this definition relate to fidiciary duty?

ShareAction recognises that some regions operate fiduciary duty frameworks that limit the degree to which investors can consider their impacts on people and planet, and this remains a significant barrier to investors being able to fully realise this definition of responsible investment in practice.

ShareAction is urging investors to do more to identify their beneficiaries' non-financial interests and actively create fund choices, with capital allocation and stewardship approaches, that facilitate the pursuit of those non-financial interests. At the same time, ShareAction is actively campaigning for legal reforms to permit fiduciary investors to give greater consideration to impacts on people and planet arising from investments they make. We expect responsible investors to take a proactive role in encouraging policymakers to evolve fiduciary duty frameworks.

What's the role of policy and regulation?

Policy and regulation have a crucial role to play in ensuring the financial system is oriented towards sustainable outcomes. ShareAction advocates for governments and regulators to increase ambition regarding financial supervision on social and sustainability issues. Mandatory requirements are needed to define the limits of acceptable behaviour, underpin a level playing field for all firms, and over time shape the culture and approaches of market participants.

However, regulatory frameworks should be understood as minimum requirements. In this sense they set the 'floor' for responsible behaviour, not the 'ceiling', and leading financial sector firms should aspire to go significantly beyond that baseline when it comes to respecting the planet and its people. History will not be kind to financial sector firms that fail to mitigate environmental and social costs simply because they refused to go beyond minimum legal requirements.

Furthermore, the relationship between market behaviour and regulation is not a one-way street. Truly responsible investors should welcome regulatory frameworks that mandate best practise can help create the space for superviosrs to introduce more ambitious standards.

How is this definition different from impact investing?

Impact investing describes a specific investment style that focuses on generating a single positive environmental or social impact alongside financial return. This definition goes further by focusing on both negative and positive impacts beyond the scope of a single positive impact, recognising the need to consider trade-offs between negative impacts and financial return, and being applicable to all investment styles and approaches.

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ShareAction is a registered charity working globally to define the highest standards for responsible investment and to drive change until these standards are adopted worldwide. Our vision is a world where the financial system serves our planet and its people.