The Case for ESG and Responsible, Sustainable Investing
How do you judge what a “good” investment is? All investors, on some level, are seeking financial returns without excessive risk. But today another factor often comes into play: What impact does the company you’re investing in have on the world? An increasingly popular investment strategy takes a company’s environmental, social, and governance (ESG) performance into account along with its potential to deliver a profit. That can include everything from a company’s employment practices and work in the community to its efforts to counteract the effects of climate change.

While attention to social responsibility has been around for years, this synthesis of supporting a better world while also seeking high returns has firmly taken hold with investors. Of the $98.4 trillion that is invested with professional asset managers worldwide, more than a third—$35.3 trillion in total—is invested sustainably, according to a 2020 report from the Global Sustainable Investment Alliance. In the first three quarters of 2021, net new investments into ESG mutual funds in the U.S. amounted to more than $54 billion, surpassing the total for all of 2020, Morningstar reports.

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“The incredible explosion of interest in ESG that we’ve seen, particularly in the past couple of years, is just amazing,” says Ted Finlay, Director of External Manager Research at Fifth Third. “ESG investing is here to stay and the numbers back that up, whether it’s interest from clients or measuring flows that are going into ESG strategies.”

As ESG has moved from the sidelines of the investing world, it has become an important consideration for any investor looking to mitigate risk and position a portfolio for growth. “This is no longer a niche strategy,” says Todd Ripley, Senior Institutional Portfolio Manager at Fifth Third. “It’s been recognized that it can provide strong returns for investors while also doing good in the world.”

While ESG approaches differ from investor to investor, they all begin with the idea that investors can better their portfolios—and the world—by focusing on certain standards. Here’s what every investor needs to understand to get started.

**ESG Investing, Then and Now**

The origins of ESG investing can be traced back to what’s referred to as **socially responsible investing** (SRI). This approach screens out sectors investors disapprove of in favor of companies that offer a positive social value. With SRI, investors typically eschew so-called vice stocks, such as alcohol or tobacco suppliers and firearms companies. Some of the earliest forms of exclusionary investing practices came from religious groups setting parameters for ethical investments. Secular groups followed suit as early as the 1970s in reaction to companies producing chemicals used in military efforts. Ecological disasters, growing concerns over
human rights around the world, and global climate change have spurred interest in SRI ever since.\(^3\)

An offshoot of SRI that focuses exclusively on the end result of an investment is **impact investing**. With this approach, an investor might try to accomplish a specific goal with their investments, be it environmental or social. Many investors who adhere to impact investing will use the same types of criteria as investors who are focused on ESG.

The term ESG was coined in 2005 at a conference hosted by the International Finance Corporation, according to *Forbes*.\(^4\) ESG involves actively investing in companies with positive ESG performance, as well as those whose products or services may be in greater demand amid a rising focus on climate change and other global challenges. While ESG is similar to SRI and impact investing, there is an important difference: Investors use ESG factors to analyze the risks and opportunities of investing in a sector or company, supplementing traditional financial analysis. Together, SRI, ESG, and impact investing can be referred to as **responsible and sustainable investing** or **ethical investing**.
What’s Driving Interest in ESG

ESG has infused every segment of the wealth management process, from due diligence to portfolio construction. While some of the change is being driven by financial institutions, much of the demand is coming from investors, with younger ones leading the charge. Three-quarters of investors under age 40 are interested in sustainable investing, according to a 2021 report by Cerulli Associates. Among investors 70 and older, interest drops to just 31%.

This generational shift in attitudes is important for two reasons. For starters, the shape of American wealth is set to change drastically over the next few decades. Baby boomers currently hold about 53% of the wealth in America, while members of Generation X control 25% and millennials hold just 5%, according to data from the Federal Reserve.

By 2030, the entire boomer generation will be 65 or older, and the transfer of trillions in assets from one generation to the next will gain steam. As that happens, the face of investing is poised to change. “Matriarchs and patriarchs may not have had concerns about the societal impact of investments in traditional alcohol, tobacco, or firearms companies, or more contemporary ESG standards, but their kids and grandkids do,” says Ripley. A study from MSCI estimates that millennial investors alone will direct $15 to $20 trillion into ESG over the next two to three decades.
Well before millennials inherit large amounts of wealth, they are wielding greater power in the workplace. With the number of millennial workers topping 56 million, this generation born between the early 1980s and the mid-1990s now makes up the largest segment of the U.S. workforce, according to the Pew Research Center. Many are already speaking up about employers’ ESG practices and sustainable retirement plan options.

THE ESG YOUTH MOVEMENT

Younger investors are more likely to have ESG in their portfolios.

Percentage Invested in ESG:

- **27%** MILLENNIALS
- **20%** GENERATION X
- **18%** BABY BOOMERS

Source: 2021 survey by Natixis Investment Managers
Institutional investors, too, are increasingly focused on ESG in response to demand from the organizations they represent and to mitigate regulatory and reputational risk associated with the companies they invest in. “That includes hospitals, colleges, religious organizations, grantmaking private foundations, and charitable trusts,” says Ripley. These institutions have long focused on goals-based investing and achieving specific milestones. But now, says Ripley, they are working to integrate values-based investing into their portfolio strategies.

Institutional investors and other large shareholders in public companies are also exerting their influence on corporate governance and other ESG policies. For example, institutional investors have started to look for so-called proactive shareholder engagement programs, where voting policies, reporting, communications, and other processes reflect a focus on ESG. Last spring, activist shareholders helped elect three new members to the ExxonMobil board of directors in an effort to spur the company to take stronger action to alleviate climate change.

Another factor contributing to the growing popularity of ESG is the realization that investors need not sacrifice returns with this strategy. The idea that ESG investing is akin to a philanthropic endeavor is less true than ever. “As individual and institutional investors become aware of the potential values and benefits of ESG investing, they will appreciate that financial returns on their investments are not sacrificed.” says Ripley.
Measuring ESG Performance

Given the groundswell of interest in ESG from investors, employees, and even regulators, companies are taking note. “There are a number of factors causing firms to realize that they need to take ESG seriously,” says Finlay. “Companies are hearing from shareholders that they want ESG changes implemented, and they are recognizing that they could be screened out of investment products or portfolios and indexes if they’re not meeting these ESG needs.”

As a result of this scrutiny, public companies are becoming transparent about their commitment to ESG. In a 2021 analysis, the Center for Audit Quality found that 95% of S&P 500 companies have made detailed ESG information publicly available. That reporting can cover everything from company culture and diversity and inclusion policies to sustainable sourcing and environmental practices.

Companies are being held—and holding themselves—to measurable standards of ESG performance. ESG analysis aims to guide the standardization of how companies report on themselves, so that investors, analysts and even the layperson can use the same set of metrics. The current lack of agreed-upon measurements of ESG leads to inconsistencies in what companies report. In 2021, for example, 28% of companies in the S&P 500 reported on their diversity and inclusion practices, but only 2% reported on water consumption or energy efficiency, according to a report from the Harvard Law School Forum on Corporate Governance.
Several efforts are underway to standardize ESG measurements to make it easier for companies to demonstrate progress—and for investors to assess which firms are truly committed to improving ESG versus engaging in so-called greenwashing, or environmental announcements aimed solely at burnishing a company’s image. The U.S. Securities and Exchange Commission has provided [general guidelines for companies to self-report](#) on ESG and is planning [new regulations](#) for companies to disclose the climate risk they face.16

In late 2020, the World Economic Forum’s International Business Council created their [Stakeholder Capitalism Metrics](#), which group ESG measurements into four areas—principles of governance, planet, people, and prosperity—and lay out the core data and disclosures that companies should report for each.17 Another international body, the Financial Stability Board, established the [Task Force on Climate-Related Financial Disclosures](#), and that group has issued recommendations for disclosure practices that can work across multiple industries. They suggest richly detailed reporting practices but stop short of defining metrics to allow for flexibility.18

All of this can make it tough for investors to assess and compare ESG performance. Advisors, portfolio managers, and relationship managers who are trained in ESG can take the overwhelming set of metrics and create specific benchmarks that are right for an investor’s portfolio.
WHAT GOES INTO E, S, AND G

Key factors to consider when you’re vetting a company for its ESG performance

ENVIRONMENTAL

1) What are the company’s levels of carbon emissions?
2) Is the company working to eliminate climate change risks?
3) Is it sourcing raw materials sustainably?
4) Is its supply chain sustainable?
5) How is it managing waste and recycling?

SOCIAL

1) Is the company maintaining positive community and customer relations?
2) Is it promoting diversity issues?
3) Is it concerned with health and safety?
4) What is its record with human rights?
5) Is it responsibly marketing its products and services?

GOVERNANCE

1) How is leadership held accountable?
2) Is executive compensation reasonable?
3) How transparent is the company?
4) What rights do shareholders have?
5) Are voting procedures clear and do they promote positive management?
What are your ESG goals?

When you’re considering ESG investing, ask yourself these questions to determine what your goals are and the kinds of risks you are willing to take.

1. **What are your values?** ESG investments can cover a lot of ground, so articulating what change you want to see in the world will help your investment team identify the types of companies and investments that will suit your values.

2. **What ESG policies matter most?** Are you more concerned with companies that have fair governance practices, or are you looking for companies that are actively working on better environmental policies?

3. **How much ESG integration do you want?** As you work with your investment team to create a plan, discuss what percent of your portfolio you want to be ESG-focused.

4. **What is your risk appetite?** All investing, including in the ESG sector, entails risk. While your advisor or relationship manager may already know your overall risk tolerance, work with them to define your risk for ESG investments.

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**Approaches to ESG Investing**

As ESG has moved into the mainstream, investors are being offered a growing array of options for incorporating ESG into their portfolios, including actively and passively managed mutual funds, exchange-traded funds, and separately managed accounts that are customized to an investor’s needs. Investors can pursue ESG strategies in international and emerging markets as well as the U.S. equity and fixed-income markets.

What’s more, some investors might want to integrate only certain ESG metrics into their portfolio strategy or dedicate just a portion of assets to ESG. Others may want to ensure that 100% of their portfolio is ESG compliant. ESG may be a global phenomenon, but the ESG choices any individual investor makes are still personal. “ESG means a lot of things to many people,” says Ripley. “Every client or institution is different, and some will have more passion around this than others.”

The proliferation of ESG choices and investing approaches offers many possibilities—but can also be confusing. The decision of whether to invest in this manner and how much of your portfolio should reflect ESG goals should be made only after conversations with your investment team. You may want to kick off that discussion by answering some questions about your ESG goals (see box to the right). “Deciding on an appropriate ESG plan is all part of a thoughtful discovery process between clients and their relationship team,” says Ripley.
From there, Fifth Third works from a fiduciary perspective to help investors succeed. The Bank provides clients with active and passive ESG investment strategies across global asset classes. With a concerted strategy, an ESG approach may help you serve the dual benefit of supporting a more sustainable world and a more sustainable portfolio.

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Wealth & Asset Management is comprised of Fifth Third Private Bank and Fifth Third Institutional Services. Franklin Street Trust Company, Franklin Street Advisors, Inc., MainStreet Investment Advisors, LLC, and Fifth Third Wealth Advisors, LLC are all indirect subsidiaries of Fifth Third Bancorp. Through these Trust and Registered Investment Advisory businesses, Fifth Third ranks among the largest money managers in the Midwest and, as of December 31, 2021, had $554 billion in assets under care, of which it managed $65 billion for individuals and organizations of all types and sizes.

Investor information and press releases can be viewed at 53.com. Fifth Third’s common stock is traded on the Nasdaq® Global Select Market under the symbol “FITB.” Fifth Third Bank was established in 1858.

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