KPMG

KPMG Investment Advisory

Responsible investment – what? why? how?

In his 1962 book, Capitalism and Freedom, Nobel Prize winning Economist Milton Friedman argued that a company has no moral obligation outside of increasing profits for shareholders, albeit within the "rules of the game", avoiding deception and fraud. In the decades that followed, increased scepticism of this view has been evident as socially constructed systems of norms, beliefs, and values have altered. Indeed, it could be argued that "rules of the game" have changed significantly and that Friedman's profit related obligation could – long term – be aligned with more socially responsible activity.

Responsible investment defined

*"an approach to investing that aims to incorporate **environmental**, **social** and **governance** (ESG) factors into investment decisions, to better manage risk and generate sustainable, long-term returns"*

- The United Nations Principles for Responsible Investment ('UN PRI')

Environmental criteria looks at how an investee company performs as a steward of the natural environment.

Social criteria examines how a company manages relationships with employees, suppliers, customers and the communities in which it operates.

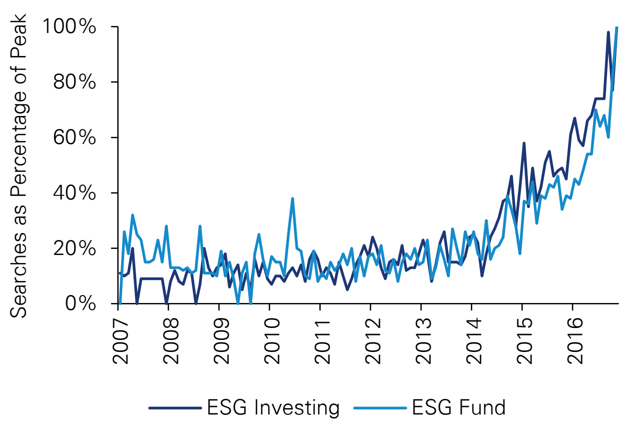
Governance criteria is concerned with a company's leadership, executive pay, internal controls, external audits and shareholder rights.

Company

Environmental	Social	Governance
Resource Use Emissions Innovation	Workforce Human Rights Community	Management Shareholders CRS Strategy
Climate Change Nuclear Energy Energy Wastage Water Wastage Pollution Natural Resources Deforestation Environmentally Friendly Technologies Green Buildings	Consumer Protection Customer Satisfaction Child Minding Services Diversity Employee Satisfaction Employee Rights Flexible Working Health & Safety Policy Human Rights Policy Supplier Protection	Anti-Bribery Anti-Corruption Anti-Takeover Devices Audit Committee Independence Board Diversity Board Member Compensation CEO-Chairman Separation Employee Relations Shareholder Rights Staggered Board Structure

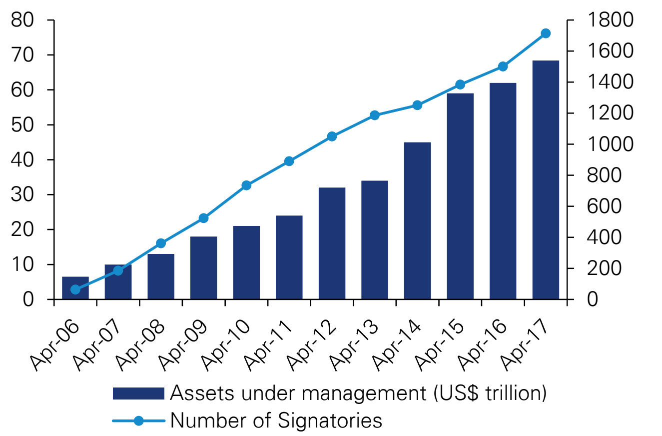
Growing trend

Google Searches for ESG Terms



Source: Google trends

UN PRI signatories and Assets Under Management



Source:UNPRI

We believe that it is important for investors to understand the options available to allow them to make informed decisions on how to incorporate responsible investing into their investment strategy.

What are the options?

Do nothing, understand the risks

Incorporating ESG into investment strategy requires additional time and resource, which some investors may not be able or willing to dedicate. It is important, however, that investors understand the risks of doing nothing. These may include **financial**, **reputational** and **regulatory** risks.

Ensure managers have ESG policies in place

For investors that wish to consider incorporating ESG, the first and most basic consideration is to ensure that their appointed asset managers have suitable ESG and monitoring policies in place. Although this might initially appear to be a 'box-ticking' response, it is a good first step and requires only marginally increased governance from investors.

Appoint managers that integrate ESG centrally

Whilst only appointing managers with ESG policies in place is advantageous in terms of "entry level" ESG forward investment, investors may wish to go beyond this approach. For instance, only appointing asset managers that directly incorporate ESG in their investment strategies and recognise it as central to the decision making process.

Strong investment stewardship governance is key to this approach and involves engaging with companies to protect and enhance the value of clients' assets by encouraging sustainable financial performance over the long-term.

Develop a bespoke ESG policy

Taking integration further, investors could develop a bespoke policy incorporating ESG factors. This is in line with 2nd UN PRI Principle which states that 'we will be active owners and incorporate ESG issues into our ownership policies and practices.'

Once an investor has customised their own ESG policy, they can take an active ownership approach to actively engage directly with companies to encourage change.

Whether or not investors wish to include ESG as part of their investment decision making process depends on the beliefs and circumstances of the investor. It is worth noting that strong engagement could lead to a status quo, which could cause others to disinvest from industries which are less than favourable from an ESG perspective in favour of ESG positive funds. This in turn could encourage sectors with poorer ESG practices in place to improve their standards. KPMG views this as a positive consequence of investors engaging in ESG and encourages clients to review their approach going forward.

To discuss the options for your investment strategy please contact:

Patrick Race
T: 0207 6944689
E: patrick.race@kpmg.co.uk

Megan Mulholland
T: 0207 311 6270
E: megan.mulholland@kpmg.co.uk

George Kendall
T: 0113 2313278
E: george.kendall@kpmg.co.uk

kpmg.com/uk

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