The ABCs of ESG

A guide to ESG investing terms

Federated Hermes

Environmental, Social and Governance (ESG) considerations are not uniformly defined across the investment industry. Below we have broken down each by some of the issues that are generally associated with those terms.

Environmental

Circular economy	Pollution and waste management	Water use	Product lifecycle
Natural resources		Climate change	

Social

Human capital management	Customer attentiveness	Human rights	Conduct and culture
Health and safety	Diversity	Stakeholder relationships	

Governance

Corporate governance	Executive remuneration	Risk management	Business purpose
Corporate behavior	Shareholders protection and rights	Capital structure	Corporate reporting
Cybersecurity		Regulation	Board structure

Terms to know:

Advocacy:

Engaging with public policymakers, regulators, governments and industry bodies on enhancing ESG and stewardship standards globally as well as regionally, at a thematic level (such as climate change or diversity) or by industry sector.

Engagement/stewardship:

Engagement with companies and stewardship as an investor includes understanding how companies align their behaviors with the long-term interest of clients and their beneficiaries by improving ESG performance. This involves direct and collaborative interactions with the board of directors and senior leadership of corporate issuers to better understand their ESG risks and opportunities and advocate for positive change.

ESG integration:

ESG integration systematically and consequentially integrates financially material ESG factors alongside traditional financial factors in investment analysis and investment decisions.

Impact investing:

Targeted investments aimed at solving social or environmental problems, including community investing where capital is specifically directed to traditionally under-served individuals or communities as well as financing that is provided to businesses with a clear social or environmental purpose.

Norms-based screening:

Investments are assessed against meeting the minimum standards of business practice based on the international norms, such as those issued by the Organization for Economic Co-Operation and Development (OECD), International Labor Organization (ILO), United Nations (UN) and United Nations Children's Fund (UNICEF).

Positive screening:

Investment in sectors, companies or projects is selected for positive ESG performance relative to industry peers.

Socially Responsible Investing (SRI)/Negative exclusion:

Exclusion of a fund or portfolio of certain sectors, companies or practices based on specific ESG criteria (e.g. excluding tobacco or weapons industries).

Sustainable Development Goals (SDGs):

A universal set of 17 goals, 169 targets and 231 indicators for global development: which serve as a blueprint to achieve a better and more sustainable future. They address global challenges including poverty, inequality, climate change, environmental degradation, peace and justice. They were established by the UN in September 2015.

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Terms to know (continued):

Sustainability-themed investing:

Investment in themes or assets scientifically related to sustainability, (i.e. clean energy, green technology, sustainable agriculture).

The Sustainability Account Standards Board (SASB):

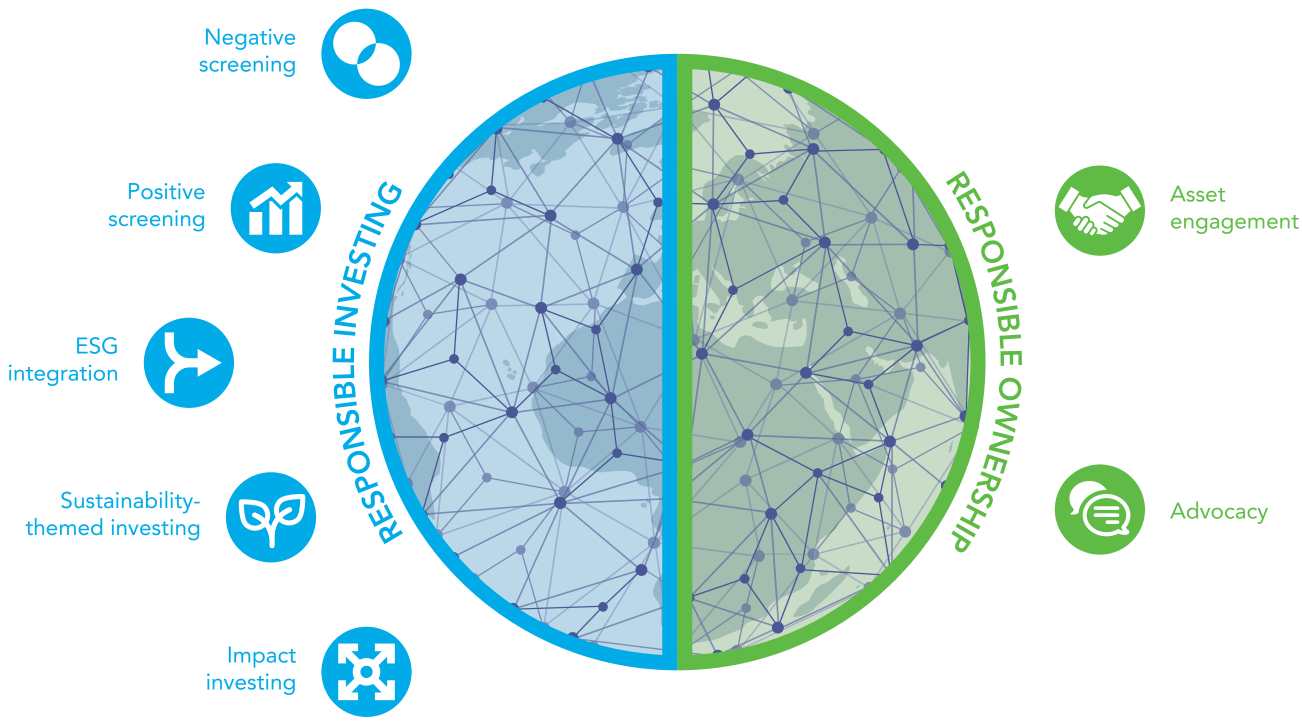
Founded in 2011, it is an independent, nonprofit whose SASB standards guide the disclosure of financially material sustainability information by companies to their investors. These standards seek to enable companies and investors to make informed decisions that may drive long-term value creation and better outcomes for businesses and their shareholders, the global economy and society at large.

UN Principles for Responsible Investment (PRI):

A voluntary and aspirational set of six investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice; it boasts more than 4,000 signatories and represents over $120 trillion assets under management. When the PRI were launched in April 2006, Hermes Fund Managers Limited (now Federated Hermes Limited), was among its founding signatories and was one of a select group of asset managers who led in the drafting process of the Six Principles. In December 2017, then Federated Investors, Inc. also became a signatory to the PRI. Our now combined firm, Federated Hermes, Inc., continues its commitment to the UN PRI and its Six Principles.

Responsible investing

Responsible investing considers ESG factors in the analysis, selection and management of investments while pursuing value creation.



Responsible investing and responsible ownership mutually reinforce each other. Responsible ownership uses asset engagement and advocacy to be good stewards and owners of companies and assets.

Terminology such as "ESG integrated", "sustainable" or "impact", among other terms, is not uniformly defined across the industry. Investment managers may understand and apply ESG factors in different ways, and that the role those factors play in investment decisions also varies. Therefore, we recommend investors understand the role of ESG factors in a strategy to ensure that approach is consistent with their investment objectives. Like any aspect of investment analysis, there is no guarantee that an investment strategy that considers ESG factors will result in performance better than or equal to products that do not consider such factors. Investing and making buy and sell decisions that emphasize ESG factors carries the risk that, under certain market conditions, the fund or strategy may underperform those that do not incorporate such factors explicitly into the decision-making process. The application of ESG criteria may affect exposure to certain sectors or securities and may impact relative investment performance depending on whether such sectors or securities are generally in or out of favor in the market.

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