

ESG and Funds: Frequently Asked Questions

What is ESG?

ESG is the acronym for environmental, social, and governance matters.

Perhaps one of the most significant recent global trends is the increasing investor interest in ESG matters. The fund industry is responding to this increased interest by, among other things, creating new funds that explicitly tailor their investments to specific ESG criteria.¹

ESG matters vary widely but generally are considered to mean:

- » environmental or “E” matters, such as climate change, resource depletion, waste, pollution, or deforestation;
- » social or “S” matters, such as companies’ relationships with their employees and suppliers, including labor standards, diversity, and human rights issues; and
- » governance or “G” matters, such as shareholder rights, bribery and corruption, executive pay, and board composition.

Do funds consider ESG factors in a similar manner?

No. Fund advisers consider ESG factors² to varying degrees, and these approaches coexist on a broad investing spectrum.

How are ESG factors considered in a fund’s investment process?³

ESG factors may be evaluated for risk mitigation and for investment opportunities. A fund’s adviser might integrate ESG factors into its traditional investment process for the fund or, for a fund with sustainable investing strategies, an adviser may analyze some E, S, and/or G factors and/or seek sustainability-related outcomes as a significant part of the fund’s investment thesis while seeking financial returns.⁴

Integration. Some fund advisers integrate ESG factors into their traditional investment processes to the extent that they consider those factors to be financially material. Fund advisers typically seek to enhance performance, manage investment risks, and identify emerging investment risks and opportunities that face the companies in which they invest. ESG factors may pose risks and opportunities to the companies in which a fund may invest and may affect the long-term value of a company’s shares. As a result, a fund’s adviser may consider ESG factors along with other matters, such as the strength of a company’s balance sheet, idiosyncratic factors relating to a company’s specific line of business, interest rates, or macroeconomic factors affecting the company or its industry. The extent to which an adviser integrates ESG factors into its investment process may vary adviser to adviser.

Sustainable investing strategies. Funds with sustainable investing strategies generally engage in one or a combination of exclusionary, inclusionary, or impact investing strategies.

- » An *exclusionary* investing strategy generally excludes certain companies or sectors that do not meet certain sustainability criteria.
- » An *inclusionary* strategy generally seeks to identify and invest primarily in companies or sectors that reflect certain sustainability-related criteria or positively tilt the portfolio toward sustainability characteristics. Both approaches seek financial return.

¹ These FAQs focus primarily on registered funds in the United States. For information about the growth of US funds that invest according to ESG criteria, see ICI’s [2021 Investment Company Fact Book](#) at pp. 60–63.

² “ESG factors” refers to ESG-related characteristics or criteria that may be considered by the fund’s adviser or subadviser.

³ A fund may be actively managed or index based. The descriptions of how ESG factors are considered in a fund’s investment process, however, primarily apply to actively managed funds.

⁴ For simplicity, the remaining questions and answers reference “ESG” broadly unless otherwise noted.

- » An *impact* investing strategy generally seeks to generate positive, measurable, reportable social and/or environmental impact alongside a financial return.

For more information and examples of these strategies, including funds using multiple sustainable investing approaches, see [Funds' Use of ESG Integration and Sustainable Investing Strategies: An Introduction](#).

Do all funds with sustainable investing strategies consider the same ESG factors and/or have the same sustainability-related goals?

No. Funds with sustainable investing strategies vary in their *areas of focus* (i.e., environmental, social, and/or governance) and in the *investing strategies* used to achieve their goals (i.e., exclusionary, inclusionary, and/or impact), in addition to other variations, such as asset classes. There is a multitude of options for investors interested in sustainable investing through funds.

For example, some funds with sustainable investing strategies may focus broadly on environmental, social, and governance matters, while others may focus on a subset of topics, such as climate change or diversity in the corporate boardroom. Even within a common area of focus, funds can take different approaches through their investing strategies to achieve their goals and objectives.

These examples show how three funds with an environmental focus can differ in their strategies.

- » Fund A may exclude companies in certain sectors from its portfolio, based, for example, on their exposure to coal.
- » Fund B may seek to invest across all sectors, for example by investing in what the adviser determines are environmental leaders—or “best in class”—in each sector, including carbon-intensive sectors.
- » Fund C may allocate capital based on companies' actions or plans regarding the transition to a lower-carbon economy, such as those reducing their reliance on fossil fuels, publishing transition plans, and setting science-based targets.

All three funds with an environmental focus reflect sustainable investing strategies but their strategies differ—and there are even more approaches firms may take. Indeed, it is important to note that exclusion or divestment of certain companies or sectors is not the only way to support a sustainability goal.

Where can I find information about a fund's approach to sustainable investing?

A fund's regulatory documents contain information about its investment objectives and strategies. All funds must issue a prospectus that sets forth the investment objectives and the principal investment strategies and risks of the fund. Because there are many different ways that a fund can consider ESG factors, investors should look to this information to understand a fund's sustainability-related objectives and strategies. Funds also have annual and semiannual shareholder reports, which can help investors understand how well a fund has met its goals and investment strategies during the reporting period. Some fund complexes provide summaries of information about their funds in fact sheets on their websites. For more information about how to find relevant ESG information in regulatory fund documents, see [Understanding Sustainable Funds: A Disclosure Guide](#).

Why might the portfolio holdings of a fund that does not have sustainable investing strategies look similar to those of a fund that does?

Advisers to funds that do not have sustainable investing strategies might nevertheless integrate ESG factors in their investment analysis to the extent that they consider those factors to be financially material. In addition, a fund may invest in companies or sectors consistent with its investment objectives and policies, such as large capitalization companies, and some of those companies may have favorable ESG characteristics compared to other companies in that category. Or a fund may be weighted in a sector (e.g., the technology sector) that tends to have certain favorable ESG characteristics. As a result, a fund that does not use sustainable investing strategies may have portfolio holdings similar to those of a fund that does.

How do funds consider ESG ratings of companies in their investment process?

Fund advisers may consider ESG ratings provided by third-party sources for evaluating investments and some may apply their proprietary analysis to ESG data. The volume of sustainability data relating to companies is growing, and third-party ESG ratings providers offer analyses of those data and other information to help investors—including fund advisers—gain insights about the ESG-related characteristics of a company. The third-party providers generally evaluate numerous reported and estimated variables for a single company and produce a single ESG rating.

Many fund advisers treat third-party ESG ratings as research inputs that are considered along with other information about the company in the investment process. Because third-party providers' ratings can be based on different estimates, assumptions, methodologies, and analyses, their ratings may differ. Moreover, a fund adviser's view regarding the ESG characteristics of a company may differ from those expressed by third-party ESG ratings providers. For instance, among other things, a fund adviser might weigh certain factors, such as social considerations, differently (e.g., more heavily) than a third-party ESG ratings provider and may have more current information about a company than is reflected in a third-party's ESG rating.

How are sustainable investing strategies reflected in a fund's proxy voting?

Funds, like any public company shareholder, may vote on proxy proposals put forth by a company's board or one or more of its shareholders. Fund boards normally delegate proxy voting responsibilities to fund advisers. A fund adviser has a fiduciary duty to the fund, which extends to proxy voting.

The great majority of proxy proposals are initiated by company boards of directors (management proposals) and are not contentious, such as those concerning the uncontested election of company directors and ratification of company audit firms. Shareholder proposals, which are typically sponsored by a small number of individuals and organizations, can cover a variety of topics, including asking management to make changes to a company's capital or governance structure, increase shareholder rights, or report on or address social and environmental issues.

A fund's shares may be voted for or against shareholder proposals, as well as company management proposals, based on, among other things, an evaluation of the long-term economic value to the fund as a company shareholder, taking into account the fund's investment objectives and strategies. Such considerations might include whether the proposal would serve to enhance value or mitigate risk and the fund's voting on matters over a multiyear holding of the investment. Based on its evaluation, a fund adviser would need to determine whether an ESG-related shareholder proposal is in the best interests of the fund, and it may not be in the fund's best interests for a variety of reasons. In that case, the fund's adviser may determine to vote against the shareholder proposal.

Funds are required to disclose their proxy voting policies and procedures and their voting records, which can help investors better understand a fund's approach to proxy voting. A fund must describe its proxy voting policies and procedures in the fund's statement of additional information (SAI), and, in some cases, the policies and procedures may expressly address how the adviser considers ESG-related matters. A fund also must annually file reports containing its voting records with the US Securities and Exchange Commission. Some fund complexes make this information available on their websites.

For more information about fund proxy voting, see [ICI Research Perspective, Proxy Voting by Registered Investment Companies, 2017](#), and ICI's [2021 Investment Company Fact Book](#) at pp. 58–59.



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