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Why a lack of definition for ESG is problematic

By Cristian Angeloni, 14 Aug 19

Transparency is key if investors want to make a positive impact

Socially responsible investments have been gaining a lot of attention and have started to become very popular among investors who wish to not only get returns on their investments but also support environmental, social and governance (ESG) issues through them.
While this proposition has become incredibly attractive especially to the younger cohorts, it does not come problem-free.

The financial services industry and bodies have yet to come to a consensus on what makes an ESG product and what the acronym stands for altogether, leaving scope for misunderstandings and different interpretations.

Some players have jumped on the band wagon by putting an ESG label on some of their products, although still featuring holdings in some ‘problematic’ asset classes such as oil, weapons and tobacco, resulting in what has been called ‘greenwashing’.

Not so green after all

This means that what has been proposed as an ESG vehicle does not fully mirror the principles underpinning this specific type of investment.

But it is not the only concern.

Simon Edelsten, co-manager of the Artemis Global Select Fund, told *International Adviser*: “Greenwashing is seen as a problem for the industry, but there is also the danger of ‘green box ticking’.

“This is where investment managers are so keen to get high scores from the ESG ratings agencies that they devote much of their energy towards satisfying the increasingly convoluted thresholds and criteria set by them.

“Many of these are of dubious benefit. Investors want sustainable returns and would like not to damage the planet or society in the process. Few see their life savings as a tool for radical political change.”

One step at the time

But Nic Spicer, portfolio manager at PortfolioMetrix, believes that even if companies are greenwashing, at least they are recognising the rise in interest in the area.

He told *IA*: “Greenwashing isn’t always a bad thing. It is at least an acknowledgement from companies that investors consider ESG to be important.

“And it may be the first step to the company more meaningfully thinking about its environmental and social impacts as well as its governance structures, particularly if clients prompt such self-improvement through engagement.”

Do your homework

But how can investors know if a product is truly ESG?

“You most defiantly cannot take the name on a fund as a guide to what is inside,” Nathan Prior, partner & head of international at Partners Wealth Management, told *IA*.

“Even something that indicates ‘climate change’ for instance, may still be heavily invested in oil companies. Whilst for some individuals this might be okay if there is an active engagement plan to change those companies, other individuals would be horrified with such use of their money.”

Unfortunately, the burden of verifying the degree of ESG falls on the individual, Prior added.

"It is very much the responsibility of the investor to do their research and dig in to see if the details match their personal ambitions or beliefs.

"The ultimate way to ensure you are getting an investment that meets with an individual's personal ESG goals is to appoint a specialist investment manager."

Be clear from the beginning

What investors can do is set out where they want and don't want their money invested in.

"As there are no clear definitions, investors must define their own objectives and priorities as regards ESG," Ayaaz Allymun, portfolio manager at Tobam, told *IA*.

"What matters most is why they are looking to invest in ESG solutions. Whatever the reason might be, they need to be properly addressed by the asset managers before clients can invest/allocate funds to them."

PortfolioMetrix's Spicer said: "At the very least, clients should insist on clear evidence that environmental, social and governance considerations strongly influence which securities make it into an ESG investment solution.

"Exactly how those considerations are defined, and the extent to which they influence the selection process will of course vary from firm to firm given underlying client preferences and investment firm philosophies.

"Individual beliefs are all unique and evolve over time, which fuels the dynamism of societal values, so we'll likely never have complete standardisation on what ESG means."

Be transparent

Masja Zandbergen, head of sustainability integration at Robeco, told *IA*: "The next step is being able to measure and report on sustainability. It's of the utmost importance that we develop a framework for this with the help of the European regulators.

"Transparency is most important: asset managers need to clearly show what is and what is not part of the strategy of the fund, no matter whether it is called sustainable or responsible, or something else.

And if companies fail to disclose their allocation they will be "quickly identified and blocked", Simon Callow, director of investment solutions at Ascencia Investment Management, told *IA*.

"It is inevitable that companies that do not operate in a socially responsible way may start to see their share prices flounder, as investors desert them."