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Keeping A Cool Head In Dash For ESG Investment

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There's a rush, it appears, by wealth and investment firms into the ESG space. This article examines the terrain and some of the challenges.

There is a land grab going on among investment and wealth management firms in the environmental, social and governance-driven approach to managing money.

These are still comparatively early days for the ESG investment sector and Asia is probably the youngest one in terms of getting into the act, while Europe and the US are a bit further down the line. Across all regions firms are scrambling to win a piece of the pie.

And they want to tell the media all about it. When this publication began exploring a run of features and articles about the topic, it was inundated with commentary offers. That's gratifying and possibly also a cause for caution – could there be some irrational exuberance?

As reported here a few days ago, the jury is out on whether ESG factors make clients better off in the long term, according to Morgan Stanley Capital International, the indexing organization more usually known as MSCI. Its comments are significant because many fund managers use MSCI indices to compare their funds against others.

With firms such as UBS, Indosuez Wealth Management, BNP Paribas, Cornerstone and Tiedemann Advisors making a noise about their ESG efforts, it looks as if firms are trying to carve out a name for themselves in this area. Even if debate continues on ESG's merits, wealth managers know they have to be at the table.

"New investment talent can help drive innovation within the impact investing industry and competition is healthy. That said, we understand the skepticism and have met our fair share of new entrants who are "greenwashing" or "impact washing" as a marketing ploy. For those trying to break through the skepticism, showcase an experienced team, a thoughtful investment strategy, a `theory of change', and a deep understanding of the systemic social and environmental challenges facing us today," Tiedemann's managing director and environmentalist, Brad Harrison, told this publication recently.

So far interest in ESG is going only in one way as far as wealth industry folk say – and that's upwards.

"We have observed growing interest from ultra-high net worth individuals and advisors, particularly those based on the [US] West Coast, looking to find ESG solutions for their client base," Bryn Gostin and Angela Willetts, co-chairs of the responsible investment committee at Capital Dynamics, an international asset manager, said.

"Within the wealth management industry, ESG investments are not currently considered `mainstream' but as interest continues to grow, wealth platforms are increasingly looking for solutions to meet this acceleration in demand," they continued.

"Importantly, the Millennial generation is at the forefront of this shift into more responsible investing and, with trillions of dollars expected to change hands from Baby Boomers to Millennials over the next ten years, the wealth management industry is acutely aware of the importance of embracing best-in-class ESG practices and investment opportunities," they said.

Data certainly backs up the growth case. The number of ESG-based assets rose by 37 per cent year-on-year in 2017, reaching $445 billion, outpacing the 23 per cent rise in the MSCI World Index of developed countries' equities. Twice as many ESG-themed funds were launched in 2017 than was the case in 2014, with exchange-traded funds proving a popular channel, according to the World Resources Institute.

Quality or quantity

There are different ways to play the ESG story, such as by taking case-by-case decisions on whether to invest in or avoid a firm or by adapting a more quantitative approach. Or one might ask rhetorically: is ESG an art or a science?

"For a long time, SRI [socially responsible investment] strategies were managed essentially by pure discretionary managers with large teams of ESG analysts. This was because the quality and accuracy of the data required a deep discretionary overlay to make them relevant and consistent from one firm to another, which made it difficult for quants to work with this data," Ayaaz Allymun, head of sustainability of TOBAM, an international asset management firm, said.

"The development of guidelines and framework such as the TCFD has certainly helped to improve the quality and accuracy of data and now allows quants to enter this field of research. There is more research done with the aim to set up a framework in the G [governance] or S [social] fields which will benefit the industry massively. We are still slightly behind when compared to the work done on the E part. It is in everybody's interest to work on accurate and transparent data," Allymun said. (TCFD relates to Task Force on Climate-related Financial Disclosures.)

Capital Dynamics' Gostin and Willetts reckon that more wealth managers are turning towards more "quant" ways of playing the ESG game.

"Historically, managers shied away from more quantitative initiatives due to the complexity of measuring ESG credentials, but we are currently observing a trend where managers are utilizing off the shelf toolkits or their own in-house designed KPIs to measure ESG more quantitatively. Each manager is monitoring different aspects of ESG but common ESG measurements include such topics as carbon emissions, health and safety record keeping and diversity monitoring," they said.

"We have designed our own in-house 'R-eye' rating system to measure initial ESG compliance for our managers and assets in a consistent manner. The 'R-eye' scorecard approach is also used to monitor and evaluate year-on-year changes. We believe ESG in ownership is as critical as ESG at entry. Furthermore, we believe our more quantitative approach to ESG measurement and data collection has the potential to better inform our investment decision making over time," they said.

Regions

TOBAM's Allymun said that the most advanced regions for ESG investing at present are the Nordics, France and North America. Capital Dynamics, also mentioned the Nordic region as being a trailblazer.

In the US, asset management titan BlackRock ($6.32 trillion in AuM) is well placed to use its financial firepower to force ESG changes, although an organization tracking this sector recently gave the listed firm a mixed report card.

At Allfunds, the fund distribution platform business that has recently pushed into Asia, it argues that demand for ESG investing is rising but acknowledges that Asia is "still in the early stages as it started from a very low base of demand".

Data

Information is expanding all the time to help managers work out where investment opportunities are – and areas to avoid at all costs. A few weeks ago, fund-tracker firm Morningstar published its annual *Morningstar Sustainability Atlas*, which shows how well the companies held by a fund are managing their ESG risks and opportunities compared with similar funds. (See here.)

Information quality and availability is crucial to making ESG work, both in public listed markets and private ones, practitioners said. Sometimes data can be patchy.

With listed markets being easier to enter in some ways than private ones, is there a danger that ESG approaches could favour the former, producing an overweight stance? Capital Dynamics doesn't think so.

"In general, we consider change to be more easily enacted in private markets than in other markets, such as listed equities. To date, change has enabled value creation within private market assets resulting in the asset class largely outperforming its public market counterparts. ESG value levers are additional tools in the value creation toolkit to enhance stakeholder value for privately held assets. Private market managers are recognizing this 'ESG opportunity' to enhance value more and more," Gostin and Willetts said.