Who to trust?

How can asset owners and investors evaluate the climate-friendly credentials claimed by investment firms?

By **Jérôme Tagger**, CEO, Preventable Surprises

Assets managed under environmental, social and governance (ESG) principles (as reported by market participants) have grown to around $30 trillion. What was once a marginal effort borne by activists is now close to standard practice in investment management. If anything, it's proof that it's possible to wish something into existence.

But what that something *is* precisely remains up for debate. It's also a source of confusion and obfuscation.

Investors, whether families or institutions, must consider two questions when considering ESG funds. First, what will the fund do for them in terms of financial performance? And, second, what will it do to make the economy more sustainable?

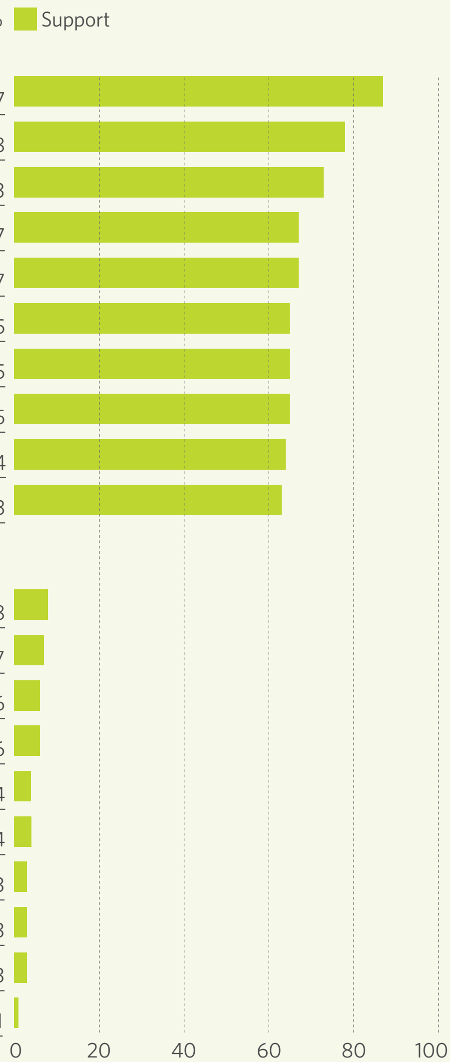
The financial performance bit leads to varied claims – of extra performance, of risk mitigation, of neutrality – based on whether and how ESG considerations affect stock selection. All of the claims are plausible. It is up to fund managers to build a demonstrable track record of their practices.

But listening to the marketing claims of ESG funds, it often sounds like integrating ESG in financial decision-making leads to better sustainable outcomes for the planet. There is, however, no evidence that what makes a decision better for an investor will spontaneously mitigate global warming, save species from extinction or turn the curve of income inequalities.

There is a feel-good dimension to thinking that it's possible to have sustainable outcomes with some superficial rearranging. But unfortunately, these big environmental and social systemic challenges require much more decisive intervention. In fact, many observers recognise that – quite the opposite – it is the

The 10 most and least supportive fund groups over five years

Fund	# of Resolutions Voted '15–19'	% Support
Most supportive		
DWS	998	87
Allianz Global Investors	794	78
Blackstone	360	73
TIAA (Nuveen)	977	67
AQR	882	67
AllianceBernstein	942	65
PIMCO	646	65
Guggenheim	929	65
Wells Fargo	1,003	64
Mainstay (Incl. IndexIQ)	976	63
Least supportive		
Federated	970	8
Hartford (Wellington)	795	7
JPMorgan	1,002	6
Amundi (Pioneer Funds)	554	6
American Funds Capital Group	737	4
Vanguard	1,033	4
BlackRock (incl. iShares)	1,033	3
Lord Abbett	706	3
Voya	1,027	3
DFA (Dimensional)	1,004	1



Source: Morningstar's Proxy Data. Data as of 11/07/19. Based on all environmental and social resolutions, voted 1 July 2014 to 30 June 2019. Votes have been aggregated over five years. Support is calculated as a percentage of all votes cast 'for', 'against' and 'abstain'.

big systemic issues that have an impact on global economic performance and therefore on investment performance. But only few have recognised the scale of the challenge, or are doing something about it.

Put simply, clients might be disappointed to learn that buying into 'sustainable funds' may have no sustainable real-world impact.

Doing your homework

So how to recognise fact from fiction? As with most decisions in life, relying on other people's assessments is often insufficient and doing a bit of homework is good. Here's a rule of thumb: if it's confusing and full of jargon, then it's probably not that good. Good plans are clear about managers' intentions, and what they will do to achieve them. Let's focus on public equities for simplicity.

To start with the obvious: memberships prove little. When an asset manager touts its membership of the Principles for Responsible Investment (PRI), the Task Force on Climate-related Financial Disclosures or Climate Action 100+, it means very little taken alone. I was a year-long, card-carrying member of the Friends of the Louvres Museum association – and set foot in the museum exactly once during that time, but the 'cool' factor was really high. And, more relevant, I was the COO of PRI for four and a half years.

Second, 'ESG integration' taken alone means nothing. What it does mean is that an asset manager has set up the pipes so that ESG data flows through its organisation. We're all proud of the fancy spices in our kitchen cabinets, but that doesn't mean we ever use them. The cool factor is equally high. And making money from inequality or climate change – the technical goal of 'integration' – isn't the same as doing something about the problem.

Third, assessment tools which are basically about self-marking – such as the PRI's assessment framework – were good 15 years ago, but have become part of the problem now. For example, BlackRock got an A+ from the PRI, but only got a D mark from ShareAction's very worthwhile recent analysis of the world's 75 leading asset managers. Why? The main difference between the two is that ShareAction took an explicit focus on outcomes and impacts and the concrete actions that managers can take towards achieving them. Just as companies have learnt how to game ESG rating agencies, so big fund managers especially have learnt how to game these self-assessment tools.

Customers should look at what sustainability goals investors explicitly pursue and how they are willing to wield their influence on the companies they invest in to support those goals, particularly on the more significant issues of our time. And very big investors should have big very impacts in the real world. Here's a handy tip: if an investor is open about actual impact, warts and all, there is a good chance they are less likely to be engaging in greenwash.

How have managers used their votes at companies' annual general meetings? There are stark disparities in the field when looking at resolutions addressing climate change or other ESG issues, as a February 2020 Morningstar report titled: *How Fund Families Support ESG-Related Shareholder Proposals* illustrates. The laggards' voting record is often widely out of line with their public commitments to climate risk.

Are the managers asking for data or for real change? Investors have tended to require disclosures from managers, whether on climate risk, gender diversity or other issues. Much better is to require action: for example, in the form of transformation plans for industries that are parties to the decarbonisation process – as Legal & General Investment Management does with its climate pledge.

Are they willing to stick their necks out? For example, hedge fund TCI has said it will vote against directors at companies that fail to disclose carbon and greenhouse gas (GHG) emissions, and against auditors when company reports do not account for climate risk. Goldman Sachs will now vote against the re-election of boards where no women are present. One can argue that the bar is low, but at least the message is clear.

Do they recognise the urgency of issues? A real climate plan should be focused on the decisive next five to ten years (some say three to five), not a vague long-term commitment. Acknowledging the climate emergency is the first step to acting on this urgency.

Do the investment managers focus on the more strategic and important companies in a given sector and the more strategic sectors? For example, BlackRock's recent thermal coal exclusion policy – something that campaigners have been pushing – does not cover the most influential players: diversified miners that include Anglo American, BHP and Glencore. Do investors who claim to be climate aware focus on influential financial sector firms – for example, the mega banks, insurance companies and media companies – or do they take the easy route and say these firms have a small direct GHG footprint?

The answers to these and related questions offer an honest and discerning perspective on the authenticity of fund managers' ESG claims. They're also a good indicator of motivation. When it's only external and responding to client demand, then fund managers will treat ESG as a marketing and compliance exercise. But when the motivation is also internal, then fund managers will take more strategic approaches. They may not be able to claim responsibility for changes in corporate practice – here, there are other voices at play including the companies themselves – but that doesn't mean they shouldn't know and express what they want.

The practical challenge is that making such an assessment is not easy. There is today no comprehensive one-stop assessment. The best one in our opinion is ShareAction's, but it only covers the largest managers at the exclusion of smaller and often more committed firms. The assumption here is also that action on climate-related systemic risk is a proxy for wider sustainability issues and this needs to be tested. There is an urgent need for clients and their investment consultant agents to come together to develop such a tool.

When the dust settles, after all, the only question on sustainability that matters is: what good have you done? ●