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Fifty Shades of Green

by Andrew Hardy, CFA

Tomorrow sees the start of our annual client conference, Think Tank, which runs for three mornings from Tuesday 14th to Thursday 16th September. From a virtual studio our team at Momentum Global Investment Management will host 13 speakers presenting on a range of specialist, investment focused topics. It's an outstanding lineup of world class investors taking to the virtual stage to share their outlooks on topics ranging from the macro to the micro, from inflation, Chinese policy risks and disruptive technologies, through to opportunities in commercial property and music royalties.

The conference provides rich insights into the themes and talent contributing to the portfolios we run for clients, and we hope that many of our regular readers will be joining us. Focusing in on one of those themes, Masja Zandbergen, Head of Sustainability Integration at Robeco, will present on the '50 shades of green', referring to the many different investment approaches taken with regards to ESG factors (environmental, social, governance) across the industry.

Europe remains at the forefront of efforts to regulate the management and marketing of ESG or sustainability-oriented investment products, through creating a clear taxonomy and ensuring greater disclosure of relevant features and risks. This began with the introduction of the Sustainable Finance Disclosure Regulation (SFDR) in 2019, with much more substantive provisions introduced in March 2021. European funds must all now be classified as either Article 6, Article 8 or Article 9.

Article 6 funds do not include any specific reference to sustainability in their investment processes and cannot be marketed along such lines. Article 8 funds, on the other hand, often considered as 'ESG integrated' funds, have sustainability factors built into their investment processes, and can be promoted as having a better profile around environmental and/or social factors. However, these article 8 funds do not explicitly incorporate sustainability goals in their objective. Article 9 funds meanwhile have specific goals related to sustainability built into their objectives and are often considered 'impact' funds.

In order to be classified as an Article 8 or Article 9 fund, the manager must demonstrate clearly how the process is designed to systematically deliver on the stated targets or characteristics, and also provide ample ongoing disclosure of ESG related characteristics and risks. This creates a level playing field across the industry and reduces risks of 'greenwashing'; expect to see more examples like the recently announced probe into DWS, the German asset manager accused of misrepresenting the ESG integration in their products. Also, expect to see similar regulation rolled out across many other countries in time.

This should be welcomed as providing much more clarity for investors around the extent to which an investment product aligns with their sustainability preferences. But in the longer term, it's likely that the integration of sustainability will be expected across the board, becoming more of a hygiene factor, as due consideration is taken for all stakeholders, rather than just shareholders.

The United Nations (six) Principles for Responsible Investment (UN PRI) are a key part of the journey for the investment industry and are likely to remain so. These principles can be considered something of a universal compass as to best practice around key sustainability issues, while the seventeen Sustainable Development Goals (SDG) represent ambitious targets for the industry and the world more broadly to work towards. The challenge for the industry in the coming years is in moving beyond seeing this as a box ticking exercise, and instead embracing the spirit of these principles and goals. All firms and investors are at different points on this journey, but all can and will go further. Most would consider actively managed strategies to have a head start in this regard in determining the true shade of green for any investment, rather than just that which a company promotes.

How investment managers achieve ESG integration varies, and any number of methods are acceptable under SFDR, but at a high level it usually boils down to one or a combination of (a) exclusions (for certain industries or controversial activities), (b) focussed impact investments (renewable energy for example) or (c) assessing all investments on their ESG criteria (effectively ensuring ESG characteristics are understood and 'priced' rather than simply focusing on traditional investment metrics). Tune in to Masja on Wednesday for more information on this.

At Momentum we use a combination of those three methods across all our portfolios, leaning most heavily on broad based integration of ESG factors, with some exclusions and some impact investments (such as in the Gore Street Energy Storage Company, whose CEO Andrew O'Cinneide will also present at Think Tank on Wednesday).

Having a more puristic view in the form of large sector exclusions and/or impact investments may be preferred by some investors, but we believe this approach brings certain drawbacks. Completely excluding certain sectors / industries means you don't have a seat at the table, making it harder to encourage progress, which can otherwise be achieved through engagement or rewarding improvement. Purely focusing on impact leads to a narrower investment universe and may make traditional return objectives harder to achieve.

Within our Luxembourg UCITS fund range, one existing global equity fund and one new multi-asset fund have been approved as Article 8 compliant. Through our parent company, Momentum Metropolitan Holdings, we are a long-standing UN PRI signatory, having been one of the early adopters in 2006. But as the 'fifty shades of green' suggest, the devil is in the detail. Tune in to Think Tank to find out more, or visit our website (https://momentum.co.uk/responsible-investing) for more information on our own responsible investment practices, or reach out to your Momentum contact!

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Important notes