IS YOUR FUND REALLY "GREEN" IF YOUR FUND ADMINISTRATION IS NOT?

While monitoring the upcoming regulations, EFA has not waited on taxonomy to act on ESG. For years, not only it takes measures to reduce its impact on environment but also to ensure a high level of ethics and human rights. The result is yet another ECOVADIS Gold Award but mostly the insurance for EFA clients that their funds stay green along the value chain.

ESG and sustainability: a growing challenge for the asset management industry

It is hard to avoid talk of climate change today. Plastic waste, Extinction Rebellion demonstrations, extreme weather events and Amazon forest fires dominate the news agenda and social media. Not for nothing has Oxford Dictionaries designated 'climate emergency' as its 2019 Word of the Year.

Environmental issues impact every sector of activity, and that affects investment funds as a key source of financing to the economy as a whole. With regulators starting to draw up rules for the asset management industry on environmental reporting and risk management, the trend among asset managers is toward incorporating environmental, social responsibility and governance criteria into their investment strategies. But a coherent and harmonised framework for ESG investment and 'green' funds is still some distance away.

According to Luxembourg's fund industry group ALFI, the grand duchy is now home to 31% of all EU sustainable funds and 39% of their assets. The European Fund and Asset Management Association claims that sustainable assets constitute more than half of the European fund industry's €25.2 trillion total, although this number is contested.

However, it seems clear that investment managers are paying much greater attention to environmental and social concerns, which are becoming an important if not necessarily overriding consideration for younger investors in their financial planning decisions. In addition to investment managers' own convictions that they need to address climate change issues, there is also growing pressure from legislators and regulators.

Defining sustainability

The biggest problem is there is still no agreement on what constitutes a sustainable company or activity. Even among research firms and index providers, the same company can be categorised very differently depending the criteria they use. The European Commission's initiative to draw up a taxonomy - a definition and classification structure - for sustainable investment is a laudable attempt to bring order to the issue, setting out technical screening criteria for 67 activities across eight sectors that can make a significant contribution to climate change mitigation.

That should help asset managers to meet their commitments under global initiatives to quantify and report on the environmental impact of their investment portfolios. Projects such as the Global Report Initiative and the Task Force on Climate-related Financial Disclosures are now in the process of being incorporated into legal requirements across the EU, Latin America and Asia, as well as to a lesser extent in the US.

Meanwhile, industry members are paying attention to the rapid growth of the $500bn global impact investment sector. This is not so much about divesting from fossil fuel extractors but actively backing clean energy projects, zero-carbon housing and other initiatives that support the United Nation's Sustainable Development Goals.

In Europe, the Commission's Action Plan on Sustainable Finance is already leading to concrete regulatory proposals for funds under the UCITS and AIFMD regimes, from disclosure requirements for funds and

their management companies to green benchmark rules. The European Securities and Markets Authority is clarifying the duties of all fund stakeholders to counter so-called greenwashing in the misrepresentation and mis-labelling of sustainable finance products and strategies.

Without broadly accepted criteria and benchmarks, that remains a difficult task, UK investment firm SCM Direct has highlighted the lack of transparency on the methodology used by different ratings agencies to reach their decisions, and how wildly ESG ratings can vary as a result. Without a fuller understanding, investors will struggle to determine how 'green' their manager and their portfolios really are and whether they match their own personal criteria.

Embracing social responsibility

Most efforts to make the industry more ethical have focused on the environmental element of ESG. Far less attention has been paid to the social responsibility and governance aspects, especially if there is no legal compulsion to do so.

The UK's Investment Association is taking a lead on social responsibility, starting with its own members. The organisation, which is running high-profile campaigns to promote diversity in the industry, says the financial services and insurance sectors are relatively good at gender balance, employing a balance of women and men that reflects society at large.

Setting an example

Business culture can be hard to change, particularly when company leaders, or even middle managers, feel threatened by initiatives such as those seeking to improve the diversity of the workforce. But there are also plenty of smaller steps that can be implemented on a daily basis by individuals – not to mention institutions that manage multi-billion-dollar investment portfolios. The 2,300 asset owners worldwide that oversee $86 trillion and have pledged to uphold the UN Principles for Responsible Assets also have a moral obligation to adopt the same standards of behaviour themselves.

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