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IMT-BLOG

THE ESSENTIALS OF SUSTAINABLE INVESTING

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The subject of "sustainable investment" is gaining in importance. Demand among investors is growing, many asset managers are taking sustainability criteria increasingly into consideration, and the legislators too are putting forward proposals for new regulation.

The following blog post provides a concise overview of the topic and discusses the most important aspects of sustainable investment.

We will be pleased to answer any questions you may have.

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THE ESSENTIALS OF SUSTAINABLE INVESTING

What is meant by sustainable investing?

The basic idea is to take ethical and ecological criteria into consideration when making investments. What we call the ESG, standing for environment, social and governance, factors form the basis for the best known concepts. The environmental factor takes in issues like CO_2 emissions, depletion of raw materials, waste disposal and pollution of air and water. The social factor involves evaluating the way in which commercial companies interact with their various stakeholders, such as employees, customers and suppliers. The governance factor entails scrutiny of companies' internal control mechanisms, decision processes and the way the companies deal with conflicts of interest.

Although the fundamental idea behind sustainable investing is easy to describe, its implementation is fraught with many and varied questions, and as yet there is no uniform, generally accepted approach.

Ways of realizing sustainable investment

Essentially, five possible ways of implementing sustainable investment can be identified.

The approach based on exclusion criteria is intended to ensure that no investments are made in companies or countries which fail significantly to fulfil the ESG criteria. As a result, whole industries and sectors, such as armaments, tobacco, alcohol, gambling etc., are barred.

When the best-in-class principle is adopted, the best companies are selected from every sector on the basis of set ESG criteria. In some cases, controversial sectors like the oil industry are considered for selection. In the best-in-class category the socially responsible investment (SRI) approach is particularly stringent, making good ESG ratings the focus of its investment strategy.

Investors taking the commitment approach utilize their shareholder rights to try to exert influence on the companies they invest in and move them to attach greater importance to ESG factors.

The thematic approach involves attempting to achieve specific ecological or social objectives by investing in, for example, offshore wind parks, fair coffee production or sustainable mobility.

Finally, investors taking the impact-investing approach aim to generate financial returns and at the same time have a favorable social impact. The idea is to produce positive, measurable effects on the environment and/or society. One well-known example is microfinance funds, which grant loans to micro-enterprises in emerging economies, which do not have access to the capital market. Alongside positive returns, the aim is to help combat poverty. Investments in this area are normally less liquid and are often in the private equity or private debt segments.

No uniform standards

In implementing approaches to sustainable investing, an assessment of the companies with regard to ESG criteria comes to bear. In this regard, a number of rating services have established themselves in the market, among the most important of which are MSCI, S&P Global, Bloomberg, Sustainalytics, RepRisk and ISS. But no uniform standards have emerged as yet, so that there can be striking differences between the ratings coming from the individual rating providers. This observation is confirmed by a series of studies pointing up fundamental differences in assessments issued by the different rating services.

One example is given by the ratings for Google's parent company, Alphabet. While the index provider MSCI rates Alphabet as an ESG pioneer in the industry, the Bloomberg rating service gives Alphabet a below-average ESG rating.

In addition, ESG ratings are prone to a number of distortions. Large companies, for instance, tend to receive better ratings than small ones. One reason for this may be that big corporations have more resources at their disposal for the partly very time-consuming and expensive process of producing the required documentation. Apart from that, European companies seem to be given better ratings than comparable companies in the USA or in emerging economies.

The impact of ESG on performance

A large number of studies have investigated how paying attention to ESG criteria influences portfolio performance. The results are not unequivocal, so that in scientific terms the studies have yielded no conclusive answer to the question. We can make the fundamental point, however, that an ESG approach which severely restricts the investment universe is more likely to have poorer risk-return characteristics.

ESG criteria from the risk management perspective

There is no doubt that the reputational and legal risks associated with the ESG factors have risen sharply in the last few years. Both the public and jurisprudence are taking an increasingly hard line against infringements of regulations in the ESG area. So for both companies and also investors it has become much more important to take ESG risks into consideration when making any decision.

ESG and asset classes

So far the ESG rating services have focused mainly on assessing companies (in particular big companies) and to some extent countries. Therefore it is relatively easy for equity funds, especially in the field of large cap stocks, to obtain an ESG rating. But for many bond funds, alternative investment funds and funds pursuing niche strategies, the common ESG analyses are completely inapplicable. Thus, it is often impossible for such funds to be rated in ESG terms.

EU action plan for sustainable finance

In view of the wide variety of rules and methods being applied to ESG, the EU Commission has recognized that regulatory action needs to be taken. The Commission has accordingly drawn up an EU action plan for sustainable finances, which is also intended to be deployed as a political control instrument.

The implications of this EU plan of action for financing sustainable growth are many and varied. The package of measures for implementing the key actions contains, for example, regulations for creating an EU classification system for sustainable economic activities (taxonomy), regulations governing obligatory disclosure with regard to sustainable investments and sustainability risks, and also adaptation to the benchmark regulatory instruments MiFID II, UCITS, AIFMD, IDD, Solvency II etc.

Summary and conclusions

Up to the present, no uniform ESG standards have been drawn up. For this reason the ESG ratings so far available should be viewed with great caution. Furthermore, a range of varying means is available for realizing sustainable investment.

As a general rule such investment may be associated with higher risk, for instance if the investment universe is too severely restricted or highly specific funds are invested in. We therefore strongly urge our clients to clearly define their objectives for sustainable investing and to discuss possible conflicts of objectives with their advisors.

The number of sustainable investment products is rising rapidly, with the result that an ever more sharply focused implementation of ESG strategy is made possible. Nevertheless, in the field of sustainable investing, careful attention to due diligence, taking the traditional risk-return factors into consideration, remains indispensable.

ABOUT US

Our first IMT Group Company was founded more than thirty years ago. Since then we have grown steadily into a group of companies, a boutique with four business divisions. Each division has its own field of competence.

We adhere to the highest ethical, professional and business standards. Competence, efficiency and transparency are of the greatest importance for us and our clients. We provide comprehensive advice to our clients, and together with them we draw up a medium- to long-term investment strategy based on the values of the family concerned.

Since the time of our company's foundation, we have successfully adapted to the changing legal and economic framework, always keeping our clients' interests in the foreground. We share their entrepreneurial spirit, and we are happy to support them in drawing up and realizing their objectives.

We take care of all the values of our clients, not merely their material assets, and we aim to help preserve them for future generations.

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