ESG is here to stay

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Long an institutional focus, ESG is rapidly gaining ground amongst retail advisers helped by regulatory change but also rising consumer demand and product availability. Managers are responding, but as ever it's a nuanced market.

Three years ago, it was difficult to find any adviser who proactively asked clients about ESG. Up until the last year or so, our conversations with advisers about their ESG processes made it clear advisers weren't comfortable with ESG nor proactively recommending ESG products.

Anecdotally, conversations with advisers showed how clients would be offered an ESG product on request. And often, after the adviser spent time and effort researching ESG product options to recommend, the client would end up going with the original recommended portfolio, because ESG "wasn't that important".

Today, things are different. The interpretation of FASEA Standard 6 has already seen 40% of advisers now proactively talk to clients about ESG issues (with many still intending to incorporate ESG into client conversations).

As a result, it is clear that ESG is here to stay.

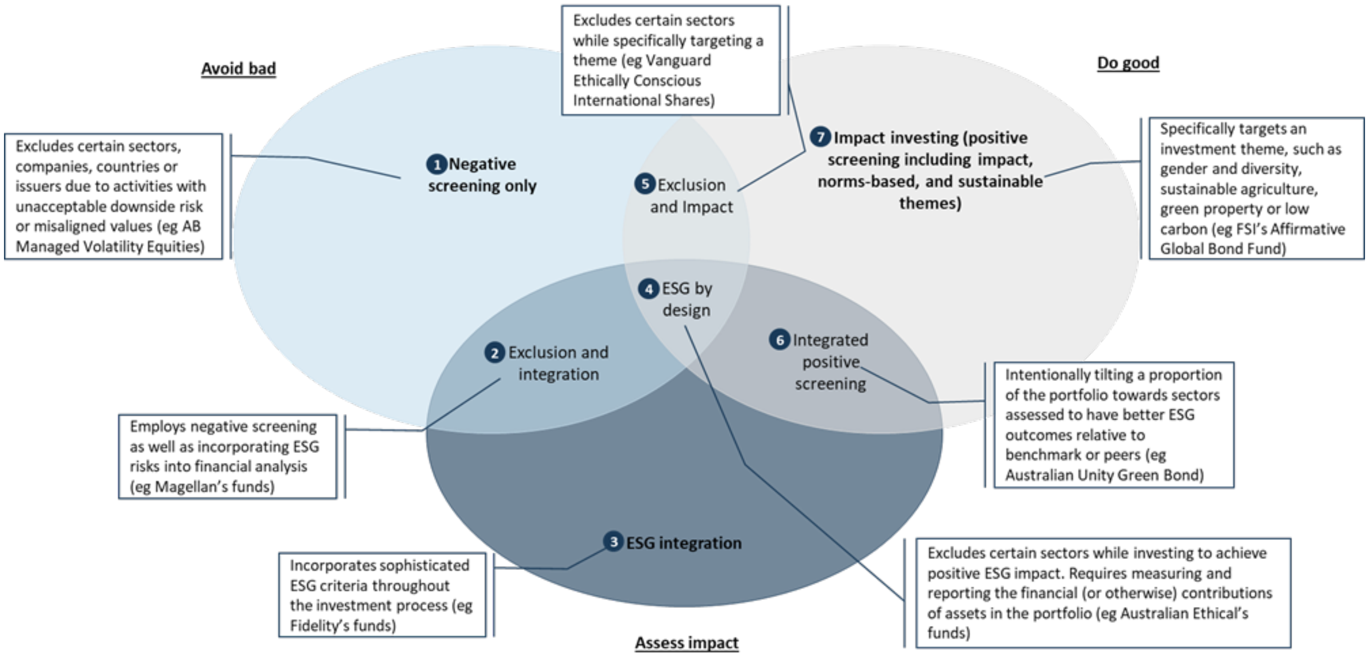
However, not all ESG is the same. As part of our recent quarterly NMG Managed Funds Review, we investigated the use of ESG across asset management products. We found there are 3 broad approaches[1] to using ESG:

1. Negative screens (ie avoid bad companies)

2. Positive screens (ie focus on good companies)
3. ESG integration (taking ESG into account in assessing risk & return)

[1] *Note, there is also shareholder activism and company engagement – which are additional activities managers may undertake to improve ESG outcomes as part of being an active owner of companies.*

However, those 3 approaches are not mutually exclusive – which gives rise to seven different categories of ESG product.



Not surprisingly, there are some significant variations in how managers participate, FUM and flow levels, and new product launch activity.

ESG Category	FUM ($bn)	Number of funds	Annual net funds flows ($bn)	Fund launches last calendar year
1. Negative Screening only	120.9	208	-5.4	26
2. Exclusion and Integration	35.2	34	2.6	4
3. ESG Integration	14.8	25	0.8	2
4. ESG by design	9.3	22	1.1	9
5. Exclusion and Impact	2.0	4	0.9	3
6. Integrated Positive Screens	0.3	2	0.1	4
7. Impact Investing	0.1	1	0.05	0
TOTAL	**182.7**	**296**	**0.2**	**48**

So, whilst negative screening was initially favoured by managers as a way to commence their ESG journey, it is falling out of favour as investors seek more sophisticated ESG solutions.

The data also shows there is:

- Currently no clear benefit or detriment in having product labelled as ESG (although as this is due to several leading managers adopting ESG within their flagship funds, this could still change as ESG becomes a more important selection factor)
- Activity across all asset classes (although activity in fixed income and property & infrastructure funds are still in their infancy with only limited product supply) and across all both listed & unlisted product structures, and

- There is a revenue opportunity, with a higher average FUM weighted fee for active ESG products compared to their non-ESG counterparts (creating an opportunity to overcome potentially higher cost of running an ESG portfolio).

As with performance, not everyone can be first quartile in ESG – but given the breadth of participation options available, it's highly likely there's one right for you! Either way it is becoming difficult to defend the lack of a clearly articulated ESG strategy – it's an area that is quickly becoming a core focus for CEOs, product, investors, researchers, marketing and distribution teams in addition to investment folks.

By Andrew Cummins