accelerando observer

ESG marketing and the risk of a mis-selling crisis February 2020

ESG is enjoying its day in the sun and asset managers are promoting their alleged ESG expertise across all marketing channels en masse. ESG fund net sales numbers reached an impressive new record in 2019. However, at the same time, the risk that the industry is heading towards another mis-selling crisis is increasing significantly.

2019 was a record year for ESG funds in Europe, posting net sales of EUR 120 billion. Just in the fourth quarter of last year, ESG fund inflows amounted to EUR 47 billion. Respective assets under management rose by 56% in 2019, well above the 18% asset growth recorded by the overall European fund universe.

In Germany, the percentage of ESG funds in total fund sales reached a whopping 40 percent in 2019, compared to 12 percent in the previous year and 5 percent in 2017. However, it must be mentioned that German ESG fund sales numbers were driven more by push than pull, with very few fund houses taking the lion's share.

360 ESG funds were launched in Europe last year and the overall number of ESG funds domiciled in Europe exceeded 2,400 funds according to Morningstar data.

With these numbers - combined with massive institutional investor pressure - it does not come as any surprise that asset managers from all over the world are promoting their ESG expertise across all marketing channels, even if their alleged ESG expertise is relatively new to them.

An asset manager without ESG integration simply gets ruled out at the very first stage of a due diligence process in many regions nowadays. This does not only apply to ESG labelled funds or ESG strategies, but also to conventional ones. It is not about ESG funds per se, but about coherent and consequent ESG integration in any given fund. Whilst this is already a widespread standard in the institutional space - at least in many regions -, it is also about to become a new norm in European wholesale fund distribution too.

"Suddenly every fund manager who comes to visit us is an ESG specialist," is a quote we hear in literally all tier one fund selector conversations these days. In addition, we witness that many fund selectors do not take ESG marketing messages at face value. Too often, the respective ESG integration and footprint remains rather light, if not half-hearted. There are simply too many who talk the talk and, as yet, do not walk the walk. This carries substantial risks, not only for the respective fund houses, but also for the relevant investors and hence for the entire industry.

There is no shortage of respective warnings. Germany's Bert Flossbach, fund manager at Flossbach von Storch, warned at a major industry event in Germany in January 2020 that if fund providers continue to slap an ESG label on every product, the industry could be heading towards a diesel gate 2.0 - a view which we very much share. Also in January, BMO's Head of Responsible Global Equities spoke out on the risk of greenwashing on the part of product providers as demand for sustainable solutions increased, stating to the British media that " the seeds are sown for the next mis-selling crisis".

A leading global fund rating provider was even forced to adapt its ESG rating methodology after a large American fund house was accused of providing misleading information and mis-selling based on the old ESG rating methodology used by the rating provider.

Too many asset managers have jumped on the ESG bandwagon in a rather hasty manner and tend to use the term or the label ESG too easily. Simply hiring two ESG analysts or buying in ESG ratings is just not good enough. The undifferentiated purchase of ESG ratings also harbours risks, which is also evident from the fact that individual companies receive remarkably different ESG ratings from different ESG rating agencies. Asset mangers that are promoting ESG must demonstrate credible, coherent and resilient processes.

Asset managers must also be prepared to be challenged on their ESG integration and footprint. Fund selectors want to understand the structure and role of the relevant ESG staff, the degree and process of ESG integration. Lots of eyes are also on external ESG research as well as on their roles within the overall investment process. A significant difference can also be made in an asset manager's ESG reports - in terms of depth and relevance. The wheat is increasingly being separated from the chaff here.

ESG is more than current Zeitgeist. It is here to stay. ESG as an essential and integral part of fund management will, without any doubt, be the new norm. However, as of now, not everything which is labelled ESG is ESG. In fact, far too many asset manager ESG stories are rather light. In consequence, the current ESG marketing frenzy may well cause more harm than good. Stop talking the talk and start walking the walk!