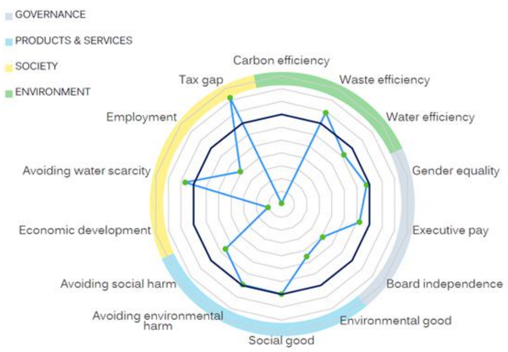
TRANSPARENT, OBJECTIVE ASSESSMENT OF AN ESG-MARKETED FUND (WITH POOR PERFORMANCE)



Fund performance is visualized as the jagged blue line with green points, compared to the benchmark which is the solid navy circle. When any green points which represent the portfolio's performance are outside the benchmark circle, that signifies a positive impact.

Impact Cubed

PICK FACT OVER OPINION TO AVOID GREENWASHING ACCUSATIONS

As the popularity of ESG and impact investing has continued to grow, so too have accusations of greenwashing – fund managers being accused of running portfolios that are "ESG" in name only, and flatter to deceive when their holdings are scrutinised.

In recent weeks, things have moved beyond mere accusations: regulators are starting a crackdown. Anecdotal reports suggest the SEC has increasingly been asking money managers to explain how they screen assets and classify ESG investment products. In August, German and US regulators began a probe into Deutsche Bank's asset management arm DWS over claims the firm had exaggerated its ESG credentials. DWS has denied it's been greenwashing, but the news sent its share price down 13.7%.

Why is this happening?

The increased flow of capital to ESG-oriented funds should be a feel-good story, so how did we get here, where impact investment products are met with scepticism?

- Part of the reason is that, at least until recently, sustainable investing was a smidge of assets under management. A lot of market participants are just now building their ESG teams and credentials. While we have robust, comparable financial disclosures for listed companies, the same is often lacking for ESG performance. So, there is a lot of capital flowing into ESG branded strategies that are unverified. Regulators are now moving to correct this problem.

- Another reason is investors' reliance on ESG ratings to promote investment offerings. These first-generation scores helped to pave the way for ESG to become more mainstream, but the scores have their imperfections. For one thing, the ratings are largely driven by how companies manage ESG risks, not by how they create solutions for a more sustainable economy. If you invest in a fund touting good ESG performance, it's a bit of a head jerk when you learn that your money is financing companies that are well-managed polluters.

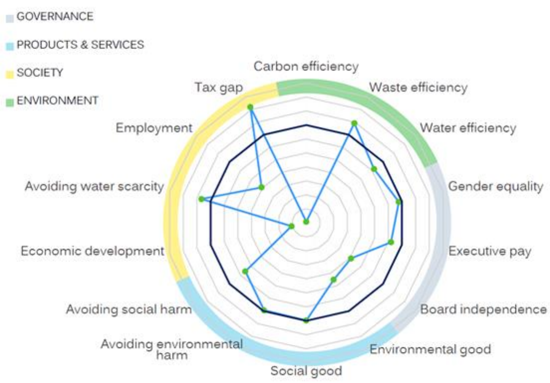
- Marketing teams, no doubt, see value in touting a high ESG rating for a fund. But these scores are blunt instruments – an opaque amalgamation of dozens of different ESG issues – and portfolio managers struggle to integrate subjective ratings in the investment process. This means that there can be a gap between what is said and what is done.

- Many mistakenly think ESG ratings are like credit ratings, which are largely the same regardless of the provider. Examples abound where a company is scored highly by one ratings provider and deemed unsuitable for inclusion in ESG funds by another. But ESG analysts use different rating schemes, so they can (and should) vary – the same way financial analysts have different opinions of what's a good investment.

Looking beyond the anecdotal, Impact Cubed research shows how ESG funds relying on scores can vary in objective ESG and impact outcomes. Not only does ESG performance vary four-fold between the "best" and "worst" passive funds: some of these ESG products had a negative impact – or a higher carbon footprint – than their benchmarks.

The figure below shows the performance of an ESG-marketed fund (the jagged blue line with green points) relative to its benchmark (the solid navy circle) on quantitative, observable ESG factors. The fund is worse than the benchmark on 11 of the 14 factors and has a net impact of −15 bps of tracking error. In other words, the fund deviated from the benchmark in ways that created a net negative impact.

Transparent, objective assessment of an ESG-marketed fund (with poor performance)



Fund performance is visualized as the jagged blue line with green points, compared to the benchmark which is the solid navy circle. When any green points which represent the portfolio's performance are outside the benchmark circle, that signifies a positive impact.

How can asset managers avoid accusations of greenwashing?

The obvious place to start is with data showing investors how the portfolio makes an impact and explaining how ESG considerations are part of the investment process. This should be informed by objective data, rather than opaque or subjective ratings.

Investors can also ask for more statements of proof. A professional investor wouldn't look at a company's marketing brochures and invest without analysing its P&L or balance sheet. The same can be done for ESG if there are transparent disclosures on the portfolio's sustainability outcomes.

If you would like to learn more about Impact Cubed's ESG factor data and portfolio impact report that shows objective, outcomes-based performance, please get in touch at info@impact-cubed.com to unlock ESG transparency for your fund.

ABOUT IMPACT CUBED

Impact Cubed provides ESG analytics and investment solutions for building more sustainable portfolios with greater impact. It combines an award-winning approach to integrating impact into risk and return with technology-enhanced portfolio design and management. The outcome is a seamless approach to customised sustainable investing.

You can find out more about our data and portfolio models at www.impact-cubed.com and if you would like to contact us at info@impact-cubed.com we would be happy to hear from you.