ACATIS FAIR VALUE SPECIAL

02/2022

Understanding the tools in sustainable investments is very important

Sustainable investments as a tool box may become the key for getting us out of the continued sustainability crisis. But only if investors and advisors learn to use the tools properly. Imagine a box ring, if you will. On one side of the ring is a growing and committed community of entrepreneurs, activists, researchers and investors. They keep pushing the human capacity for invention in order to achieve sustainable development. Their objective is clear: The actions of today's generations cannot adversely affect the opportunities of future generations.

One the other side of the ring is a very small group of - let us be honest - mostly older and very wealthy men. They are in charge of a huge and highly-effective machinery that delays measures for fighting climate change and maintaining biological diversity. The consequences of their actions, and the resulting inaction, mean that they could enter the history books as one of the biggest killers of all times. The first camp, the good people, is gaining ground, as confirmed by the most recent wave of green political promises. However, the second camp has been very effective at preventing ecological-economic progress for decades, as illustrated by the increasingly grotesque but urgently required CO2 reduction curves and long lists of endangered species.
We do not know how this story will end. History will show the outcome. I am firmly convinced that sustainable investing – also referred to Sustainable Finance - will contribute to winning the fight for sustainable development. But we have not reached our destination yet. Here are the reasons: From exclusion criteria to impact the era of Sustainable Finance 1.0, which was defined by exclusion criteria, was followed by the era of Sustainable Finance 2.0, which focused on ESG data, in the 1990s. It was followed by the era of Sustainable Finance 3.0, which now focuses on real-life impacts. The fact that sustainable investing has reached the mainstream is a very positive development. That also applies to the new emphasis on "impact".

At the same time, there are two obstacles that block the meaningful promotion of sustainable development: Tentative intermediaries and still incomplete sustainability data limit investor interest in sustainable solutions. This was shown by our study on private banks and advisors (reports: Sustainable Investing Capabilities of Private Banks; and Impact Investing: Mapping Families' Interests & Activities) and the challenges surrounding the provision of consistent ESG ratings (essay: Aggregate Confusion), as well as information about physical climate risks (essay: Let's Get Physical). Since advisors have not received adequate training, brokers are not able to inform investors about sustainability and impacts. A lack of standardisation and questions about the validity of data make it difficult to build trust - a key requirement for every investment decision. We have to refine our tools to make progress in this area. Players at all levels are confusing the purpose of the four sustainable investment strategies.

A positive impact can only be achieved if one is clear about the mechanisms of this impact. We have identified and investigated these mechanisms in our essays and reports (Can Sustainable Investing Save the World & The Investors' Guide to Impact).
Examples of such mechanisms are investments in brown companies that become less brown through the exercise of voting rights and engagement, or support for impact-oriented start-ups, where the infusion of capital generates a lot of added benefits.
In a recent article in USA Today, a former expert for sustainable investments complains that there are still many ESG funds that include companies from industries that damage the environment - which are the opposite of ESG investments. That is nonsense. An ESG fund will add companies from any industry (including oil and gas) to the portfolios if the company has done reasonably well when it comes to reporting its CO_2 emissions, the composition of the Management Board etc.

Investors who do not have oil and gas in their portfolios need an exclusion filter. Investors who wish to change the oil and gas sector can look at an ESG-activist fund that is very serious about exercising its voting rights, or an Impact Fund that finances start-ups that offer solutions.

As easy as it sounds, greenwashing has now been joined by impact-washing, as demonstrated by the case of DekaBank, which was sued because of an Impact calculator. All this can lead to a situation in which laypeople will stay away from sustainable financial products for a long time. And to top it off, the European Commission could prohibit funds that call themselves "sustainable" or "impact" if they do not apply exclusion criteria and instead focus on actively exerting their influence. This could hamper the potential effectiveness of sustainable investments.

As a society, we have a lot of leverage to win the fight for sustainable development. We can do it if we understand the tool box of sustainable investment approaches, and if we apply them correctly.

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