

ONLINE RETAIL INVESTORS: CAN'T SEE THE WOOD FOR THE TREES!

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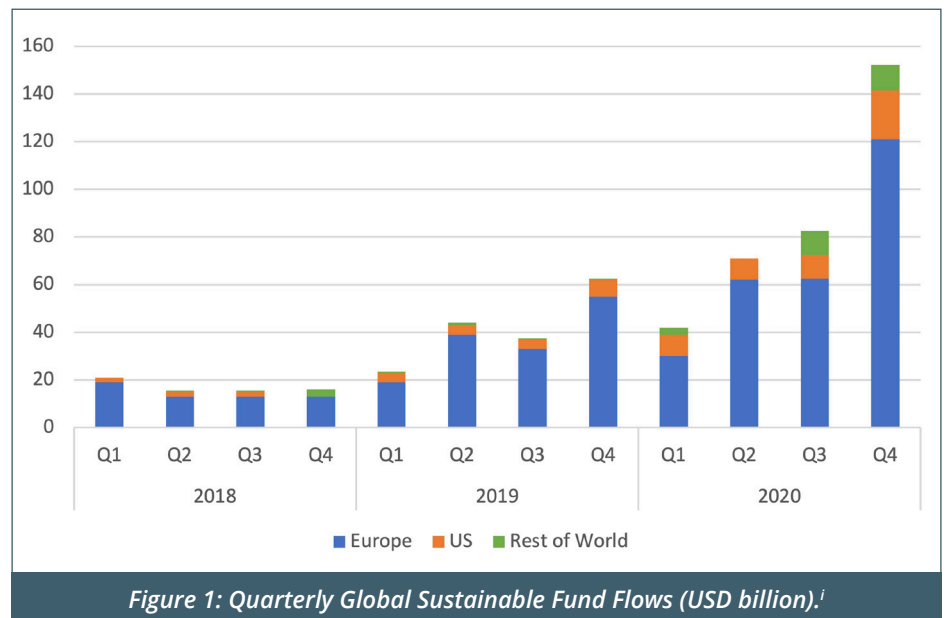
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Key Takeaways

- Despite the rapid increase in ESG retail products, investors will find it difficult to know what they are buying.
- We reviewed 22 investment websites, using deforestation as an example important sustainable theme and found that not one of them provided an opportunity to exclude deforestation.
- There is a clear opportunity for investment managers to innovate and offer more tailored ESG products and then to provide retail investors with a way of finding them on their websites.





Summary

There has been a huge increase in demand for ESG¹ or 'sustainable'² investments. A growing number of retail investors want to invest in funds that allocate capital to sustainable businesses that avoid funding environmental and social harms³ - see Figure 1.

Deforestation is a major driver of climate change⁴ and a significant factor in biodiversity loss⁵. As such it should be a core focus for investors who want their capital to fund positive environmental effects. However, our survey of 22 investment websites showed just how difficult it is for investors to find sustainability-linked investments that match their criteria.

Although 78% of mutual fund providers and 64% of ETF providers we surveyed offered ESG investments, the actual choice on offer was small. On average ESG investments accounted for only 7% of the investments available.

We could not find a single fund that specifically excluded deforestation risk.

Our review of investment websites suggests asset managers and investment platform providers are missing an opportunity to provide investors with ESG investment choices that fully match their requirements and reflect their values. We also believe that asset managers may be underselling the products they already provide as a result of the poor-quality investment selection tools offered on many investment websites.

Investors want sustainable investments - the question is: will investment website providers change to meet that demand?

¹ ESG (Environmental, Social, and Governance) - we discuss the challenge of terminology in this note

² The EU's Sustainable Financial Disclosures Regulation' (SFDR) uses the term 'sustainable investments'

³ TrackInsight's Global ETF survey 2020 showed that 86% of the professional investors surveyed intend to increase their exposure to ESG ETFs (36% plan to increase their exposure by more than 20%)

⁴ The IPCC estimates Forestry and Other Land Use causes 15% net of direct Greenhouse Gas (GhG) emissions compared to Transport which for example causes 14% (average for 2007-2016) <https://www.ipcc.ch/report/ar5/wg3/summary-for-policy-makers>

⁵ This is a complex issue - deforestation may not always lead to biodiversity loss but it always significantly disrupts the ecosystem. Landscape-scale forest loss as a catalyst of population and biodiversity change By Gergana N. Daskalova, Isla H. Myers-Smith, Anne D. Bjorkman, Shane A. Blowes, Sarah R. Supp, Anne E. Magurran, Maria Dornelas, Science 19 Jun 2020



Growth in sustainable investments

Investors are reallocating their capital towards sustainable businesses. Research published by Morningstar showed that at the end of 2020 'sustainable'⁶ funds reached USD 1.65 trillion, as a result of record inflows during 2020.

The vast majority of ESG assets under management are currently held in funds domiciled in Europe, but although the US only accounted for 14% of the total at the end of December 2020, there are clear signs of rapid growth in US sustainable funds (Q4 2020 US flows were double the average for the previous three quarters and nearly four times greater than the average for 2019) - see Table 1.ⁱⁱ

Table 1: Global Sustainable Funds 4Q 2020 Statistics.ⁱⁱⁱ

Region	04 2020 Flows		Assets		Funds	
	USD billion	% Total	USD billion	% Total	#	% Total
Europe	120.8	79.3	1,342.8	81.3	3,196	77.0
United States	20.5	13.4	236.4	14.3	392	9.4
Asia ex-Japan	5.0	3.3	25.4	1.5	208	5.0
Australia/New Zealand	1.2	0.8	19.8	1.2	126	3.0
Japan	3.7	2.4	17.7	1.1	138	3.3
Canada	1.2	0.8	10.2	0.6	93	2.2
Total	152.3		1,652.3		4,153	

This clear trend is even more marked when one compares inflows into ESG funds with inflows into 'non-ESG' funds. In Europe, where ESG funds represent 11% of the overall European fund assets under management according to Morningstar, ESG funds attracted USD 121 billion in Q4 2020, compared to USD 149 billion that flowed into the other 89% of the funds available.

In other words, ESG funds grew 10% in Q4 2020 whereas 'non-ESG' funds grew only 1%.

Sustainable ETFs are following the trend

Morningstar includes Exchange Traded Funds (ETFs) in its analysis, but data provided by TrackInsight, a global ETF analysis platform which analyses trends in ETF sales separately, shows that sustainable ETFs are also experiencing strong demand. TrackInsight's research^{iv} showed that sustainable ETFs grew by 223% over 2020, with nearly 200 new sustainable ETFs listed during the year (taking the total to over 540) - see Figure 2 on page 4.

This trend has continued into 2021 -TrackInsight logged January 2021 as a record month for ESG ETFs, with USD 20 billion added (11.5% growth in the month compared to an overall growth rate for European ETFs of 1.8% and US ETFs of 2.9%).

⁶ Terminology is a challenge - Morningstar uses the term 'sustainable' whereas TrackInsight refers to ESG. In this note we use the terms 'ESG' and 'sustainable' interchangeably.

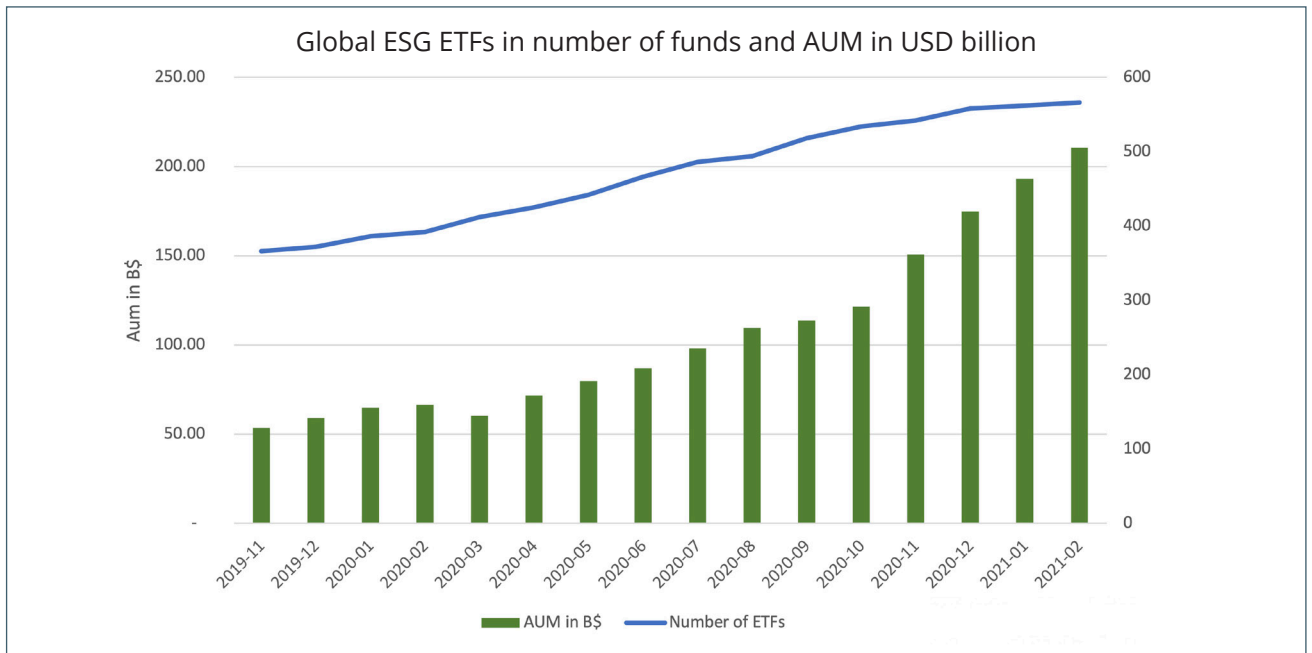


Figure 2: ESG ETFs – Assets Under Management (AUM) and Growth of Listings.^v

Funds are also rebranding as 'sustainable'

It is no surprise given the clear demand for ESG investments, that fund managers should be repurposing (and rebranding) existing funds to make them more attractive to investors.

Morningstar identified 253 funds that switched to an ESG focus in 2020, with 87% of them rebranding in the process (typically adding terms such as 'sustainable', 'ESG', 'green', or 'SRI' to their names to highlight the change and ensure they could be easily identified by investor searches) - see Figure 3.

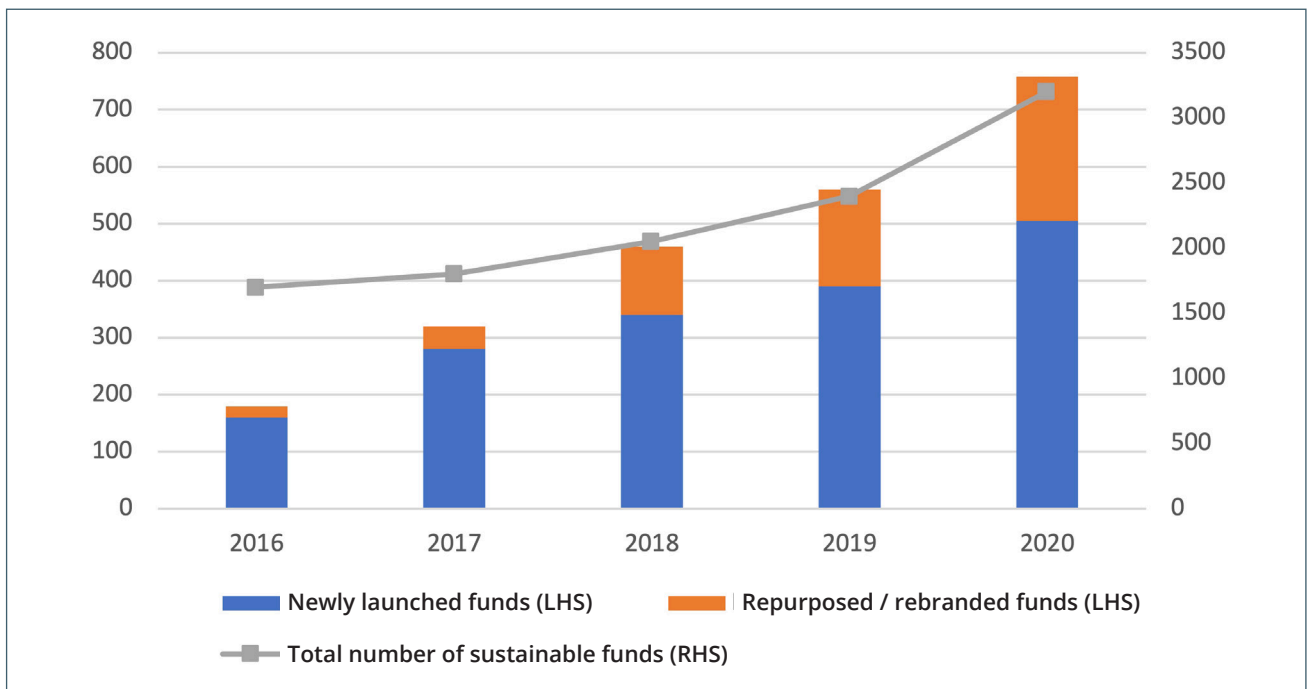


Figure 3: Newly Launched and Repurposed Funds in Europe.^{vi}



Provided this represents a genuine change to the underlying investment approach (as opposed to greenwashing) this trend is to be welcomed since it provides clear evidence of asset managers responding to the demand for sustainable investments from their clients and will in turn have an impact on their capital allocation, shifting capital away from businesses that do not meet their sustainability criteria and towards those that do.

The challenge for investors – finding a sustainable investment that meets their criteria

The challenge for retail investors who are motivated to consider the planet when investing their hard-earned cash is how to find an investment that is right for them.

There is no agreed terminology for investors to use when searching for a suitable investment fund. As noted above, fund managers label their sustainable funds in a variety of different ways (ESG, green, SRI, etc) and so identifying all the potential funds to consider can be a challenge.

This greenwashing risk may be reduced with respect to investments managed by EU fund managers as a result of the EU's 'Sustainable Financial Disclosures Regulation' (SFDR)^{vi} which took effect on 10 March 2021 and will require fund managers to publish ESG information on their websites and in investment prospectuses, both in terms of the objectives of the fund and its performance against those objectives.

However, beyond the EU investors must rely on the tools provided by the asset managers themselves, and the various investment portals, to help them find the investment vehicle that they want.

Asset managers are missing an opportunity

We decided to put these tools to the test, assuming the role of a retail investor. We reviewed 22 websites offering retail investors (or their advisors) tools to select funds and/or ETFs aligned with their investment views and attitude to risk.

Given the clear market demand for 'sustainable'/ESG investment products we were surprised to find how difficult it is for a retail investor to identify the investment product that could meet their needs.

Some asset managers are investing significant resources in designing, constructing and managing investment funds and ETFs that offer their clients the ability to focus their capital on businesses that are actively reducing the harm they cause to the planet (or even exploiting the opportunities arising from the switch to more sustainable business models), but they are falling down badly when it comes to making the results of their labours transparent to their retail clients, as our survey shows.

It is not just retail investors who are finding this a challenge. TrackInsight's 2020 Global ETF Survey revealed that professional ETF investors are also finding it challenging to identify the ESG products they want - see Figure 4.

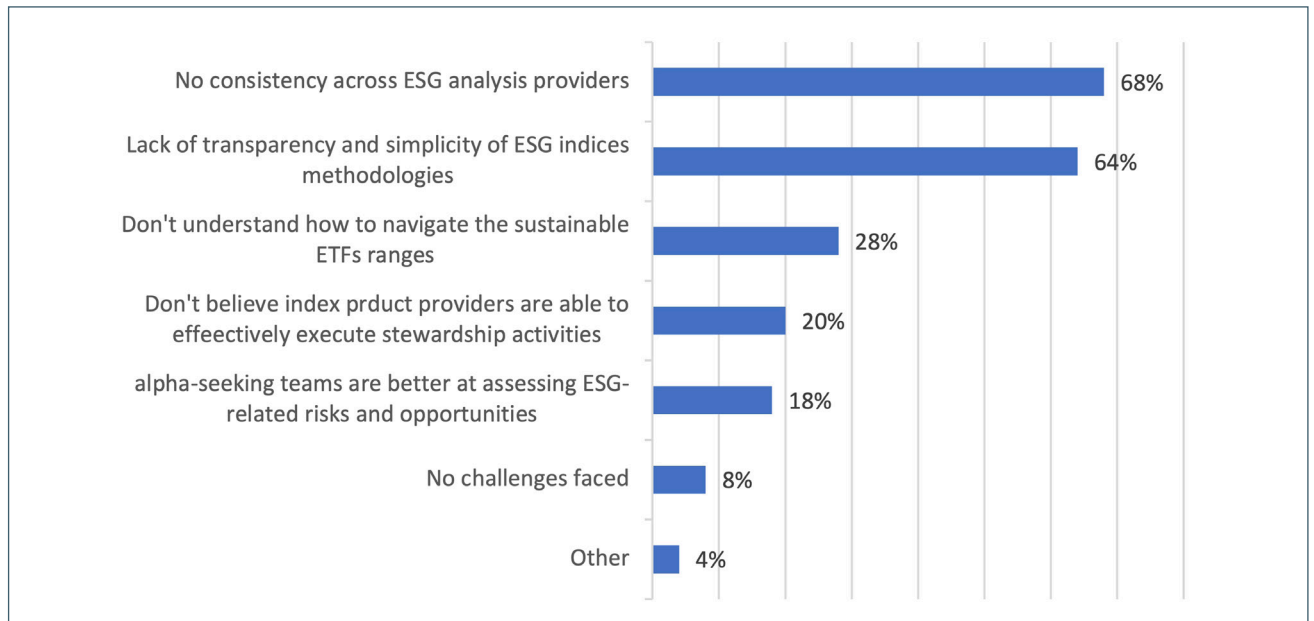


Figure 4: Main Challenges of Investing in ESG ETFs.^{viii}

Deforestation as a test case

To add focus to our survey, we imagined that our retail investor was particularly concerned by deforestation and wanted to identify funds that would avoid this risk.

We chose deforestation because it is a significant driver of climate change and a major cause of biodiversity loss. It is also an issue that we have previously covered in relation to ETFs (Exchange-traded deforestation), so choosing deforestation as our environmental harm allows us to build upon that paper.

We assumed that our retail investor had a lump sum to invest and wanted to find a fund or ETF that would allocate her money across a broad range of equities or bonds (or both) while avoiding funding companies that carry significant deforestation risk. We assumed she understands financial products reasonably well and feels capable of conducting her own research using the tools provided on retail investment websites.

The survey

- In February 2021, we investigated 22 websites offering retail investors / financial advisors the ability to select funds and/or ETFs. 16 of the websites only offered products from a single fund manager and 6 were platforms offering products from multiple fund managers.
- 11 of the websites provide access to mutual funds and ETFs, 4 only provide access to ETFs, and 7 only provide access to mutual funds.
- We used each website to search for 'ESG' (and similar terms) and investigated if the website would allow us to filter or select for different ESG strategies.
- We also ran a specific word search for 'deforestation' on each website (and tested other common ESG-related terms such as 'Alcohol', 'Gambling', 'Weapons', 'Tobacco', etc).



Survey results

Most websites offer sustainable funds, but the choice is usually limited

Asset managers offer retail investors a very wide range of investments. IG featured 8,498 ETFs on its website, and Charles Schwab offered 5,320 mutual funds, but the number of sustainable investments we found was significantly lower even though most of the asset managers we surveyed offer some.

78% of the mutual fund providers and 67% of ETF providers in our survey offer sustainable investments. However, the actual number of investments on offer is still small. The average proportion of sustainable investments across the providers we surveyed is 7%⁷, although a few of the providers we surveyed offer a higher proportion of sustainable investments (for example, 44% of the funds offered by Schroders appear to be sustainable funds).

As noted previously, Morningstar has identified 4,153 sustainable funds (including ETFs) whereas the greatest number our imaginary retail investor identified was 524 ETFs (TrackInsight) and 214 mutual funds (Charles Schwab). While some of the funds Morningstar has identified may not be available to retail investors, the obvious conclusion is that either our imaginary retail investor is less adept at finding sustainable funds than she told us she was⁸, or that the websites we surveyed are not very good at presenting their sustainable wares.

Search functionality is very poor

22 websites is a small sample of the range of investment providers so that might explain why we found relatively few ESG investments. However, 6 of the websites we surveyed were portals (offering access to investments from a variety of asset managers) so we would expect them to help us cover more ground.

Given that, we are inclined to blame the websites for our limited success. Our survey clearly showed that the search functionality offered by most of the websites we surveyed was very poor, particularly in the light of the clear demand for ESG products.

Over 70% of websites fail to offer an ESG filter

Half the websites we surveyed offered investors the ability to filter mutual funds and/or ETFs by asset class using check-boxes or drop-down menus which made it easy and quick to reduce the number of investments to be reviewed in more detail. Some of the other half that didn't only offered equity investments anyway so selecting by asset class was not necessary, but that left a surprisingly high minority that lacked what we would regard as basic functionality.

A number of websites offered an enhanced user experience by allowing investors to filter the investments on offer by ratings (eg Morningstar), by charges, and by other characteristics such as region (eg LatAm, Europe, etc), fund size, or size of company invested in.

So the technology to offer investors the ability to filter the funds available clearly exists.

⁷ TrackInsight's ETF Screener showed 524 ESG funds, 7% of the 6992 total. When we surveyed IG's website we only identified 169, 2% of the 8498 total.

⁸ Understandably, she did get bored after looking at 22 websites



But few of the websites we surveyed allowed their customers to filter for 'ESG' (or any similar term) – given the clear demand for sustainable funds we find this surprising - see Table 2.

Table 2: Summary of Website Survey (filter/search facilities).

	Mutual funds website	ETFs website
Investor can filter for ESG	22%	29%
Investors can use a search box to hunt for ESG	61%	57%
No ability to find ESG investments	17%	14%

Although we often could not filter for ESG (or a similar term), a majority of the websites we surveyed offered a crude word search facility which we could use instead (even that basic feature seemed to be absent from a surprisingly high minority of websites).

Only one website offered the ability to search for particular ESG strategies

Out of the 22 websites we surveyed, only one (TrackInsight) provided a facility to search for particular ESG strategies. The other 21 websites presented a 'take it or leave it' view of their ESG investments – if we wanted to know what a particular investment offered from an ESG perspective we had to read the underlying documentation (and even then it was not always that revealing).

But the TrackInsight ETF screener offered several alternative filters.

The first filter allowed us to select ETFs according to four broad categories:

- Full integration: full integration factors ESG considerations into investment selection and decision-making processes to mitigate risks or enhance returns.
- ESG thematic: thematic ETFs focus on one specific theme (for example gender equality or low carbon).
- Best-in-class: best-in-class approaches select the most sustainable companies or leaders across sectors.
- Exclusion screening: exclusion approaches eliminate companies or industries that do not meet minimum standards of sustainability based on international norms.

The second filter allowed us to select ETFs based upon a rating methodology provided by Conser.⁹ In essence this methodology identifies a consensus ESG rating for a particular company which TrackInsight then aggregates based on information about the ETF's underlying holdings to achieve a rating for the ETF itself.

Finally, TrackInsight allowed our imaginary investor to filter ETFs based on their exposure to one or more of the UN Sustainable Development Goals (SDG) – although it is noteworthy how few of the SDGs are currently specifically covered by ESG ETFs - see Figure 5.

⁹ <https://www.TrackInsight.com/news/wp-content/uploads/CONSER-ESG-Methodology.pdf>

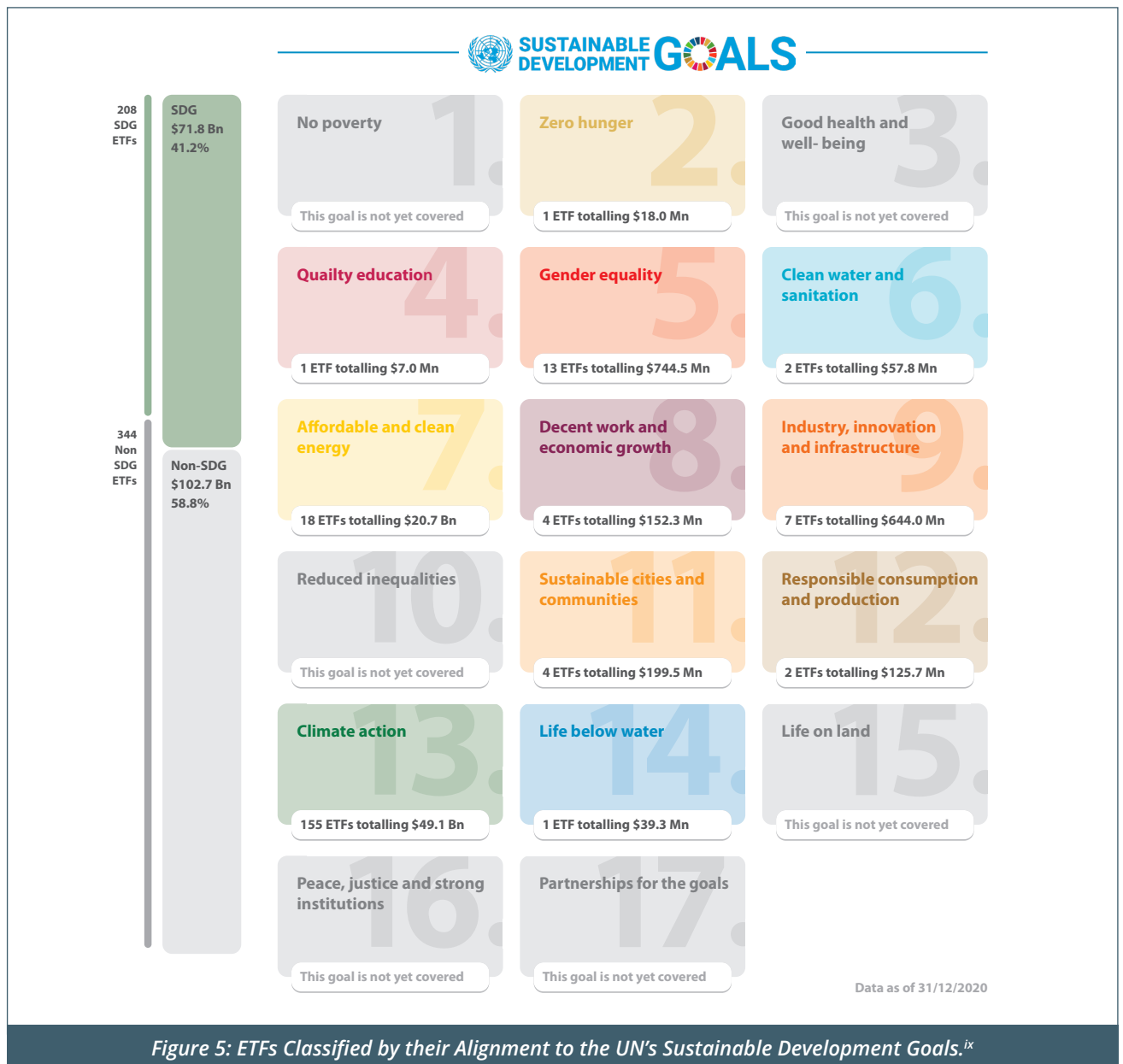


Figure 5: ETFs Classified by their Alignment to the UN's Sustainable Development Goals.^{ix}

Deforestation: none of the investment providers provided what we wanted

As noted above, once we had persevered with the poor functionality of the majority of websites we were able to identify ESG investments, but our troubles were far from over.

Our imaginary retail investor is keen to find an investment that avoids deforestation risk but none of the websites we surveyed allowed us to filter for specific environmental, social, or governance harms.

Only TrackInsight came close by offering the ability to filter by UN SDG but that still required us to identify which SDG might be most likely to lead us to ETFs excluding deforestation risk.

We did a word search for 'deforestation' on all the websites that provided this facility but none of them revealed a fund or ETF matching this criterion. Just in case we had picked a tricky word we also searched for terms that commonly featured in the investment policies of ESG funds in the past (such as alcohol,



gambling, weapons, etc) but none of the websites revealed any funds as a result of those searches either (even though we know from reading the investment fact sheets that some funds specifically screen out investments associated with these activities).

Clearly the search function provided was not fit for our purpose.¹⁰

So, the only way for our investor to find what she wants would be to read the investment Fact Sheets of all the ESG funds thrown up by her earlier website search.¹¹

We know there are ESG funds that screen companies out based on the fact they are exposed to alcohol, gambling, etc, but this survey and our previous work suggests that providers of ESG investments are doing a poor job of creating products that meet the requirements of investors seeking to allocate their capital to sustainable activities and away from environmental harms.

Invest Your Values websites – a partial solution?

Our focus in this note was to examine the extent to which retail investors were being helped or hindered by the investment selection tools on offer from asset managers and investment portals.

As our investigation showed, retail investors are currently not well served by these websites.

However, a series of websites run by As You Sow^x demonstrates that the technology and data exist to allow investors to search more effectively for sustainable investments.

As You Sow's websites cover seven different themes:

- Fossil-free funds (<https://fossilfreefunds.org/>)
- Gender-equality funds (<https://genderequalityfunds.org/>)
- Gun-free funds (<https://gunfreefunds.org/>)
- Deforestation-free funds (<https://deforestationfreefunds.org/>)
- Weapon-free funds (<https://weaponfreefunds.org/>)
- Tobacco-free funds (<https://tobaccofreefunds.org/>)
- Prison-free funds (<https://prisonfreefunds.org/>)

Using the Deforestation Free Funds website our hypothetical investor could easily have identified funds aligned to her desire to avoid deforestation risk.

The website provides some helpful search tools to enable an investor to narrow their search (e.g. selecting only ETFs or mutual funds, and/or filtering by different grade levels for the other criteria listed above such as 'Weapons').

However, even this website does not provide everything our investor wants:

- The funds covered are only US funds, so the much larger universe of European sustainable funds is missed;
- The website does not provide the same level of search functionality provided by the better websites in our survey in relation to non-ESG factors (such as asset class, passive management, expense ratios, etc.).

¹⁰ Ironically, using the search function would sometimes reveal a blog or article regarding deforestation showing it was a topic of interest to the fund manager / portal provider, but this interest was hard to detect in their investment funds.

¹¹ We did this for a few ESG investments but even in the documents provided it could be very difficult to identify precisely what the asset manager was doing to select investments for the fund.



What's inside the box?

When we discuss deforestation and other natural capital risks with fund managers we often get the response that 'we design investment products based on what our clients want'. But our survey shows that clients will find it very difficult to choose what they actually want, either because it is not available, or because the selection tools provided are so poor.

As we discussed in our previous report, the major index providers are partially responsible for the lack of choice with regard to ESG investments, but there is some evidence that asset managers are beginning to design their own indices or ask mid-tier or niche index providers to do it for them.

We believe there is a significant opportunity for innovation in terms of sustainable investment product design and also to significantly improve the tools provided for investors to find the ESG investments they want. The Invest Your Values and TrackInsight websites show what is possible from an ESG perspective.

When the EU's Sustainable Finance Disclosure Regulation (SFDR)¹² takes effect on 10 March 2021, it will force EU asset managers to be more transparent with regard to ESG. This offers EU-based asset managers an opportunity to turn that transparency to their advantage and globally lead in this space.

Terminology – ESG vs sustainable

Terminology is a challenge. Fund managers use a wide variety of labels to describe what might broadly be called investing with a broader purpose than simply seeking a financial return.

There are no agreed definitions - in this note we use the terms 'ESG' and 'sustainable' interchangeably as shorthand for all such investments.

Other common labels applied to these investments (or to a narrower range of investments that fall within this broad category) include:

- Socially Responsible Investments (SRI) – this label has largely been replaced by ESG;
- Ethical (often associated with the exclusion or 'screening out' of particular business activities such as alcohol or gambling);
- Impact investing.

Morningstar uses the label 'sustainable'. Its definition is '*we categorize as sustainable those open-end funds and exchange traded funds that, by prospectus, fact sheet, or other available resources, claim to have a primary sustainability objective and/or use binding ESG criteria for their investment selections.*'

The EU uses the term 'sustainable investment'. This is defined as '*investment in an economic activity that contributes to an environmental objective' or 'an investment in an economic activity that contributes to a social objective, ... provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance.'*^{xi}

¹² The goal of the **EU SFDR** is to increase transparency on sustainability among financial institutions and market participants. It consists of disclosure requirements on firm and product levels, to standardize sustainability disclosure. This is needed to improve industry-wide comparability and prevent greenwashing.



Annex 1: Survey details

Table 3: Planet Tracker Retail Website Survey Results.

Website provider	Asset manager or platform	Can investor filter for ESG (or similar)?	Must use search box	Does the provider offer ESG funds/ETFs?	Can investors filter/select for different ESG strategies?
Amundi	AM	Y	Filter for Responsible Investing	Y	N
BlackRock	AM	N	Must use search box	Y	N
BNY Mellon	AM	N	Must use search box	Y	N/A
Capital	AM	N	Not possible to search for ESG products	N/A	N/A
GSAM	AM	N	Must use search box	Y	N
JP Morgan	AM	N	Must use search box	N	N/A
Legal & General	AM	N	Must use search box	Y	N
Liontrust	AM	Y	Filter for Sustainable	Y	N
PIMCO	AM	Y	Filter for ESG	Y	N
Prudential Financial (PGIM)	AM	N	Must use search box	N	N/A
Schroders	AM	Y	Filter for Sustainability	Y	N
State Street	AM	Y	Filter for ESG	Y	N
Vanguard	AM	N	No search facility	Y	N
AJBell YouInvest	Platform	N	No search facility	N	N/A
Charles Schwab	Platform	Y	Filter for 'Socially Responsible'	Y	N
Fidelity	Platform	N	Must use search box	Y	N
Hargreaves Lansdowne	Platform	N	Must use search box	Y	N
IG	Platform	Y	Filter for 'Socially Responsible Fund'	Y	N
Interactive Investor	Platform	N	Must use search box	Y	N
iWeb	Platform	N	Must use search box	Y	N
Standard Life	Platform	N	Must use search box	Y	N
TrackInsight ETF screener	Platform	Y	Filter for 'ESG strategies'	Y	Y



Annex 2: Deforestation – a definition

The following definition of deforestation has been produced by the Accountability Framework Initiative.^{xii}

Deforestation

Loss of natural forest as a result of: i) conversion to agriculture or other non-forest land use; ii) conversion to a tree plantation; or iii) severe and sustained degradation.

This definition pertains to no-deforestation supply chain commitments, which generally focus on preventing the conversion of natural forests.

Severe degradation (scenario iii in the definition) constitutes deforestation even if the land is not subsequently used for a non-forest land use.

Loss of natural forest that meets this definition is considered to be deforestation regardless of whether or not it is legal.

The Accountability Framework's definition of deforestation signifies "gross deforestation" of natural forest where "gross" is used in the sense of "total; aggregate; without deduction for reforestation or other offset."

Degradation

Changes within a natural ecosystem that significantly and negatively affect its species composition, structure, and/or function and reduce the ecosystem's capacity to supply products, support biodiversity, and/or deliver ecosystem services.

Degradation may be considered conversion if it:

- is large-scale and progressive or enduring;
- Alters ecosystem composition, structure, and function to the extent that regeneration to a previous state is unlikely; or
- leads to a change in land use (e.g., to agriculture or other use that is not a natural forest or other natural ecosystem).



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