March 2022

Diving into the challenges… 3 ways to help your ESG funds products become winners

In this, the second half of my interview with Verena Charvet last week, we look at the importance of and tips for finding out what your target market wants from your investment products.

Read Part 1

Joining the Dots of 3 Decades of ESG:
https://merlys.uk/3-decades-of-esg-joining-the-dots/

Recapping on that which Verena pointed out previously: "with ESG funds, financial market participants need"

- ***a solid understanding of the rules and regulations***
- ***to be clear about what products their target market wants***
- ***to be realistic about how best to meet and deliver both of the above***

…so it's this the second bullet point we're covering today

3 WAYS TO HELP YOUR ESG FUNDS PRODUCTS BECOME WINNERS

1. Finding out what your target market wants from an ESG fund

"With a fiduciary duty (and sometimes a performance-based contract) to maximise returns for investors and pension fund holders, **it seems obvious that finding out what they want from an ESG fund would be standard procedure**," said Verena "but not everyone does it.

Pleasing multiple different investor groups is a challenge. "By way of an example, a number of relatively high profile legal cases in 2016-2018 in the US **highlighted how – within just one group of investors – there can be opposing views**.

In these cases, brought against pension fund administrators, a collective group of fund holders **sued the administrators** for what was in effect held to be a 'dereliction of fiduciary duty'.

In these instances, the administrators had, at its simplest, invested with more regard to ethical investing **without ensuring that they had openly declared this strategy**, and the resulting returns were proven to be lower than the returns with a more traditional investment allocation.

It **polarised the pension fund holders** affected: one camp was incredibly happy with the returns they received from a feel-good sustainable strategy; and one disgruntled group sued for damages because they should have made more." Verena said.

Verena then contrasted this with an English law case from just a few years later.

As Verena explains "in that case the English Supreme Court concluded that it was unlawful to prevent the "quasi trustees" of a local authority pension fund from taking non-financial considerations into account when making investment decisions, provided that such considerations do not pose a significant risk of financial detriment to the scheme and there is good reason to think that the members would support taking that decision."

Verena also highlighted some interesting work in this area by the International Actuarial Association (again from 2020) called ***Global Developments in Pension Fund ESG Disclosures → what pension actuaries need to know*** (see: https://www.institutdesactuaires.com/global/gene/link.php?doc_id=16269&fg=1).

Top Tip 1:

"Look at the regulations governing the desired product structure and ensure you are absolutely clear on what you must achieve from a regulatory perspective. And remember, the fund belongs to the investors. Once it's created, it's very hard to change."

2. Understanding the new breed of investors who are calling the shots. Ask them!

"In Europe, Pension Fund Holders and Trustees are **feeling the pressure from individual investors and activists** to do more and provide more sustainable and ethical investment options," Verena said.

"A few years ago, I worked with a 400-year-old very traditional German bank, and was involved in some very **valuable investor research**."

"For hundreds of years, the backbone of the bank's client base was dominated by aristocratic old money, but more recently the Bank was increasingly attracting a band of self-made and wealthy younger clients."

"When the Bank **asked their younger clients what they wanted from their investments**, there was a marked difference between what the 'old guard' had always wanted and what the younger clients were seeking.

This new generation of wealthy and 'woke' investors told the Bank that they **didn't care for access to traditional funds and investments**," said Verena.

"The Bank quickly realised that, in order to keep the young new money invested with them. they needed to offer funds more focused on environmental, social and corporate governance issues!"

Top Tip 2

*"**Ask** your target market what they want. Investor research provides incredibly valuable feedback that you can use to better develop, target, and promote your products."*

3. Use the mechanisms regulation is providing to gather investor feedback.

"Before Brexit, MiFID II included guidelines on 'the whole of the chain of responsibility for products'. It provided **a mechanism to get shareholder and investor feedback** from the distributor to the product manufacturers.

The intent was to **create more transparency and clarity about target market concerns**, and allow the product manufacturers to gather information and assess whether products are meeting the needs of the target market." Verena said.

"It's been slow in coming and it's not perfect And although it is still not being done well, this approach is what the UK's FCA Guiding Principles and the EU Taxonomy Regulations are trying to do: *to make sure that financial products are not just good at what they say they are good at, but the* ***products are, essentially, suitable, of value and are not costing the investor the earth.*** *Literally!" Verena said.*

Top Tip 3:

Listen to Brandon Horwitz and I discuss 'Assessment of Value in our recent video ('AoVs for AFMs').

Currently, Verena is working with a number of small and medium sized clients - who provide ESG funds. These clients either don't have the manpower or their overstretched legal, compliance and product development people simply can't keep on top of all the regulatory change or reporting requirements. As a funds-sector regulation expert and consultant, who brings the added value of being a lawyer, Verena and a team of specialist consultants provide advice through to implementation of regulation at both a strategic and hands-on implementation level.

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Verena Charvet, interviewed by Leanne Mills, a previous colleague from Barclays Wealth, who is now a business writer.

Verena Charvet MBA | Managing Director at Merlys Consulting

Connect: www.linkedin.com/in/verenacharvet/
Email: verena.charvet@merlys.uk
Call us +44 (0)20 7821 0191
Follow us: www.linkedin.com/company/merlys/
Website: www.merlys.uk

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