Credibility of sustainable funds in doubt

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Funds claiming to invest with an environmental, socially responsible or sustainable bias are increasingly fashionable.

About €53bn ($74bn) is parked in such products, and there is hardly a bank that does not offer the option of investing sustainably to its customers.

The question is do they do “what it says on the tin”.

Different studies in the past have shown that sustainable funds produce similar returns to “regular” funds. However, funds sold as being especially green, socially responsible or ethical seem to have another problem: statistically, they are not more sustainable than any other equity fund.

A recent, but as yet unpublished, study by the University of Zurich measured the sustainability of large sustainable funds with the help of the RepRisk-index (RRI), and compared their RRI scores with those of regular equity funds. The result is a disappointment: the scores of both categories are almost identical.

The RRI can be used to measure companies’ sustainability performance. It is based on thousands of third-party news items about companies taken into the RepRisk database in nine languages, which refer to environmental, social, and governance topics. Values are attributed to the quality and relevance of the sources as well as the news content and the severity and newness of the issues discussed.

Felix Remmers, author of the study, is not surprised by his results: “The shares that are in so-called best-in-class-sustainability funds overlap to a large extent with the ones we find in regular equity funds. Hence it is no surprise that these specialised funds are statistically not more sustainable than their regular colleagues.”

An earlier study, published in 2004 in the US, found similar results: more than 90 per cent of the single equities that are included in the Fortune 500 index can also be found in sustainable investment funds.

There is a second reason that explains the result of the new analysis: most fund managers – be it of regular or green funds – are trying to beat the same benchmarks. The more these managers drift away from their chosen benchmarks, the greater the risk – risk they are often not willing to take.

The new study is a blow to investors who have entrusted green and social funds with their capital. Is it all just false labelling? No, says Philipp Aeby from RepRisk, the company which developed the RRI.

Mr Aeby says the RRI does not show the whole truth. It is only an indicator for reputational risks companies have with respect to environmental and social issues. Nevertheless, he believes the results are potentially explosive: the analysis does show that some managers of sustainable investment funds rate the intentions of companies instead of the actual effect their business behaviour has on society and the environment.

“That way, those sustainability funds potentially cannot live up to their promises,” says Mr Aeby. The supervision of business activities is crucial, he thinks. Sustainable investment funds that invest in companies that systematically violate human rights or destroy ecosystems are not credible.