# The ESG debate:
# What shade of green are you?

In the tribal world we inhabit, we're constantly encouraged to take sides. Brexit or Remain? Pro-science or anti-vaccine? Team Harry or Team Wills? Whatever the divide, people want to know which side you're on.

Tribalism is a natural human tendency; we want a group we can bond with. But, it certainly has been on the increase, fuelled in part by social media. And one of the problems with it is that it fails to reflect opinions as they actually are. Few people are entirely one thing or the other; most of us are somewhere between each end of the spectrum.

ESG is just such a divide, and 2022 was the year it turned tribal. The inflection point, arguably, came in July, when Stuart Kirk resigned from his post as global head of responsible investing at HSBC, after making controversial remarks minimising the risks of climate change.

The story emboldened several financiers and right-wing politicians to criticise "woke capitalism". Meanwhile, for the first time in a decade, figures from Refinitiv Lipper, showed that more money was withdrawn from ESG funds over the course of the year than was invested in them.

Enthusiasts for sustainable investing therefore began 2023 firmly on the back foot. And many are starting to question whether ESG really is the unstoppable force we've been led to believe it was going to be.

## A debate that was long overdue

As an advocate of sustainable investing, I welcome the debate that Stuart Kirk and others have generated. It was long overdue. There is plenty that's wrong with ESG and that requires major improvement. But to suggest that it's in any way a busted flush would be a grave mistake.

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**Enthusiasts for sustainable investing began 2023 on the back foot questioning whether ESG investing really is an unstoppable force.**

ESG can, and does, have a positive impact on corporate behaviour and, by extension, society and the environment. I would also suggest that, if they had it properly explained to them, the vast majority of investors would be supportive of it.

Unfortunately, that lack of knowledge and understanding is a big problem. Most people haven't had ESG properly explained to them. James Kirkup from the Social Market Foundation recently highlighted this in The Times. "I work at Westminster," he wrote, "and spend a lot of time talking to politicians about economic and financial issues. I could probably name fewer than a dozen who are familiar with ESG and its meanings.

"If the politicians don't know enough about ESG, pity the member of the public glancing at the forms for their defined-contribution pension and wondering what happens if they tick the box for 'ethical' or 'responsible' investments."

Sadly, this information gap only encourages tribalism, and political commentators are always keen to take sides. Among the general public, however, there's probably a bigger consensus on ESG than many of us imagine.

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## Shades of green

The fund industry talks in terms of Light Green and Dark Green. The distinction relates to the Sustainable Finance Disclosure Regulation (SFDR), introduced by the European Commission in 2018. Specifically, a Dark Green fund has sustainable investment as its sole objective; a Light Green merely promotes environmental or social characteristics.

If we applied this same distinction to investors, and indeed to people generally, I myself would probably be a cross between the two. Mid Green, if you like. And I actually think that most people in Britain today would fall into the same category.

So, what do Mid Greens think? Here are eight key principles that ESG moderates like me generally agree on.

1. We broadly believe the science that man-made global warming is a fact.

2. We're not eco-warriors, but we do accept that time is running out to avert the most serious potential consequences of climate change.

3. We are willing to take steps to reduce our personal carbon footprint — eating less meat and flying less frequently, for example — but we respect the freedom of individuals to make their own decisions.

4. For us, sustainability is not just about the environment; it's also about social cohesion and doing the right thing by our fellow human beings.

5. We want companies to be good corporate citizens, not to harm the environment and to treat their employees fairly.

6. In so far as it's possible for investors to have a positive impact on the environment and on wider society, that's what we would like.

7. First and foremost, however, we invest because we want the financial returns we need to help us lead the lives we want.

8. We acknowledge that there may sometimes be a conflict between 6. and 7. and that compromises will need to be reached.

9. Because we lead busy lives, we have neither the time nor expertise to decide on the compromises referred to in 8. and would like financial professionals we can trust to make those decisions for us.

## More that unites us than divides us

Of course, we're not going to agree on every single issue. Take, for example, the recent withdrawal by Vanguard from the Net Zero Asset Managers initiative. Friends and colleagues with a similar outlook to my own reacted to that news very differently; some heavily criticising Vanguard's decision, others supporting it.

Mid Greens will also disagree, often very strongly, about specific issues — abortion being an obvious example. And there are bound to be those for whom the E in ESG is more important than S, and vice versa.

But my point is that there's plenty of common ground, and far more issues that we agree on than we disagree about.

So what sort of investment solution is right for Mid Greens?

Some financial advice firms have chosen to specialise in serving activist investors; others provide impact investments, which particularly appeal to investors who want to support projects in their local areas. Neither approach is right for me. I don't have the time or the interest to be an activist, and nor am I convinced that impact funds will provide me with the financial returns I'm looking for.

Other advice firms have made ESG the default investment solution. I don't have a problem with that approach, and there are certainly many, many people to whom it will appeal. My own view, though, is that it should be up to individual clients to decide what they want to do. From a purely financial investment perspective, I do have reservations about doubling down on ESG.

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## Four crucial components

For me, the best investment approach is one that combines four things:

1. the benefits of global diversification via broad market indices;

2. access to the premia that academic research shows is provided by stocks with certain characteristics (value stocks or stocks with smaller market caps, for example);

3. higher exposure to companies which have higher ESG scores, without detracting from the main return drivers; and

4. a systematic process that doesn't rely on large teams of analysts or active bets made by highly paid individuals, thereby reducing how much I have to pay.

In my view, one asset manager that does all four of those things well is Global Systematic Investors. I'm not, I acknowledge, a totally impartial observer — I have worked for GSI as a freelance consultant for several years — but I would say the same thing if I hadn't.

A systematic investment solution that overweights companies with higher ESG scores is the logical choice for the majority of advice firms. No, it won't be right for every client, but it will be right for most clients. And, for most advice firm owners, that's surely more than good enough?

If we applied this same distinction to investors most people in Britain today would probably be a cross between the two. Mid-Green.

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